EUROPEAN UNIVERSITY INSTITUTE
Florence

FRENCH INTER-WAR MONETARY POLICY: UNDERSTANDING THE GOLD BLOC

CHARLES MADDISON

PART I

Thesis approved and awarded the Degree of Doctor in Economics of the European University Institute, Florence, Italy, on 10 June 1994

Members of the Jury:

Prof. Alan Milward, London School of Economics (President)
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"Notre devoir était de défendre le patrimoine des épargnants. La dévaluation est une faillite. On ne fait faillite que s'il n'y a plus d'espérance d'amélioration. Ce n'était pas le cas en 1934."

L.GERMAIN-MARTIN (1936)

"La dévaluation en diminuant la valeur du franc, frappe tous ceux qui ont des revenus fixes, elle diminue les revenus réels des salariés, des rentiers, des petits commerçants et des paysans.

C'est une folie de prétendre que la dévaluation peut ramener la prospérité. Elle ne pourrait que précipiter notre pays dans une misère plus grande."

J. Duclos - speaking on behalf of the communist party.

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INTRODUCTION

This thesis explores the nature and objectives of French monetary, exchange rate and economic policy in the 1930s. Until Eichengreen's (1985 & 1992) and Mouré's (1991) work, the conventional wisdom was that French policy was, misguided (*q.v.*, Hawtrey) or characterised by financial ignorance (*q.v.*, Kemp, 1972). This judgement came readily to British analysts who felt that the French were too slow to abandon the old orthodoxy which their own country had discarded five years earlier (the British and many others having abandoned gold in 1931, whereas the French and the Gold Bloc only in 1936). As a result the French were forced to deflate in the 1930s, whilst the British reflated.

These once traditional views take inadequate account of important differences between French and British experience and policy in the 1920s (when sterling was overvalued and the franc undervalued), and they take no account of differences in political structures and institutions which placed different constraints on France (and some other Gold Bloc countries) than on the UK.

I feel that if we are to understand why France did not devalue earlier, it is essential to investigate closely what the political, institutional, and attitudinal constraints were in France.

My thesis therefore involved investigation and assessment of French policy options as they were perceived at the time. This is done by a study of the archives of the *Ministère des Finances* and the *Banque de France*, and French diplomatic correspondence, before and after the 1933 World Economic Conference, in the archives of the *Ministère des Relations Exterieurs*. I also examine the views of different political groupings by exploring the record of parliamentary debates and the newspaper clipping files at the Royal Institute of International Affairs at Chatham House, as well as those held at the *Banque de France*.

My thesis which explores the sociology of policy-making therefore makes a much more detailed analysis of the inter-play of opinion and policy-making than Eichengreen and Mouré have done, though I share their revisionist assessment of the quality of French policy.

It is a central tenet of this thesis that French inter-war currency experience cannot be understood *in vacuo*, and that a holistic political and economic approach is essential to grasp the interaction of historical circumstance, ideology, and politics which made for the particular course which policy took. Foreign policy illusions and the domestic political imperative of financing post-war reconstruction expenditure through borrowing, as a German liability, explains the substantial post-war deficits. The resulting experience of inflation, currency depreciation, and the sacrifices made by the *rentiers* with the Poincaré stabilisation acted as constant referent to policy-makers and analysts.

Why did the French political establishment fail to resolve the fiscal crisis of the state any sooner? To understand this it is necessary to analyze the nature of the French polity from an institutional perspective in terms of the relations between presidency, executive and the legislative, viz., the Chamber of Deputies and the Senate. It is also necessary to apprehend the nature of parties and fluid political groups which acted within these mediating structures. The role of the radicals is crucial to understanding the difficulties of building a solid majority around a defined set of policies. These difficulties were compounded by the inability of the executive to request a premature dissolution of the Chamber of Deputies or referendum. From 1926 onwards, the method increasingly used to broker a parliamentary impasse was the grant of decree-making powers. These temporary delegations of parliamentary authority would no sooner be reclaimed. Attempts at constitutional reform ran against the vested interests of the radicals, in particular, who, as the necessary ingredient of any coalition either of the right or left, stood to lose most.

Why the French obsession with the gold standard and did it conform to the reality of the gold standard in the pre-1914 world? French policy-makers held to a text-book 19th century analysis of the gold standard and its neutral automaticity. This seems to have derived more from innate liberal economic predilections than sound historical analysis of the workings of the gold standard. The interpretation of the self-equilibrating nature of the pre-war gold standard is essential to understanding the dominant French analysis of the cause of the depression and therefore prescriptive policy action.

Most French policy-makers argued that the causes of the depression lay in the failure to find a new economic equilibrium in the immediate post-war period. Adjustment was disrupted by inflationary credit policy on the part of the US Federal Reserve System and the Bank of England. The depression constituted the necessary cathartic process towards reaching a new equilibrium, and intervention could only delay this process. France rejected the accusation that it deliberately acquired gold and destabilised the international monetary system in 1928-32. Instead it blamed the US and UK for running too loose a monetary policy. The Bank of France would stand ready to discount any sound commercial bills, but would not be drawn into any artificial expedients which smacked of managed money, such as open-market policies. Similarly in the depression years, the Bank and the French policy-making establishment rejected the use of open-market policies to stimulate activity on the grounds that this would constitute an unwarranted intrusion in the market place.

We will show that the case against devaluation derived from a well articulated economic and political model. We will demonstrate that the French political establishment was not opposed to devaluation by 1935, but was insistent that this should occur within the framework of a tripartite currency agreement. Such an agreement should preferably incorporate a commitment to return to the gold standard.

Whilst the US was willing to discuss this the British government was adamantly opposed to any fixed exchange rate commitment, particularly in 1935 which was an election year. This proved a major stumbling bloc along with the rather desultory fashion in which the US administration approached the question. It was only when the Popular Front government faced a persistent drain of reserves that a Tripartite Agreement was reached with the British and US governments. This lent a veneer of international co-operation to France's devaluation.

Why did the Popular Front government fail to devalue on coming to office and, or, introduce exchange controls? To understand this it is important to realise that the Popular Front was a heterogeneous coalition of radicals, socialists and communists. The communists were virulently opposed to devaluation, arguing that it was a method of reducing real wages, the radicals were none too keen either, and would certainly have opposed exchange controls. Perrot's (1955) assessment was that no party advocating devaluation could have won the election.

Why this aversion to devaluation? Devaluation was considered a moral and contractual default, and the experience of the 1920s suggested that devaluation and inflation went hand-in-hand.

This thesis will demonstrate that French policy-makers were far from financially ignorant and that policy rested on a coherent liberal political and economic paradigm. Its economic basis rested on what is now known as supply-side economics and the new classical macro-economics. We will see that devaluation was rejected on the grounds that it would lead to imported inflation and compensatory wage demands in the private and public sectors.

Whilst devaluation might bring a temporary fillip to economic activity it was argued that any competitive advantage would soon be eroded by wage-push inflation and public sector demands would further burden the budget. When it became evident to policy-makers that devaluation was inevitable France continued to press for a general stabilisation agreement preferably with a commitment to ultimately return to gold. This thesis shows that this was necessary for domestic political reasons, both because of the success of the previous campaign against devaluation and the need for a political cloak to disguise a policy *volte face*, but also internationally to avoid retaliation. French policy-makers sincerely feared that sterling, which was under a managed float, might be allowed to weaken and that the US might devalue the dollar from the prevailing 59% of its former gold parity to 50%, as Roosevelt was empowered to do. Lastly questions of credibility were not absent from the desire to reach an international agreement, rather than take a unilateral course and risk being buffeted by "speculative" currency flows as in the 1920s.

Our thesis also demonstrates that when British policy-makers such Hawtrey encouraged France to engage in open-market operations following the *de facto* stabilisation of the franc in 1926 they had failed to understand the political reasons for which the Bank's statutes specifically precluded open-market policies. In effect the Bank's statutes aimed at making monetary policy independent of government and to prevent a recurrence of the budgetary monetisation which had characterised much of the period to 1926. We will see that this past experience also explains why the Bank rejected open-market operations to offset the effects of depression in the 1930s. The second factor which informed the Bank's quietist attitude was that it firmly adhered to the "banking principles" that is, it was prepared to discount all sound commercial bills presented to its discount window. That these were not presented in sufficient quantities was not the Bank's fault but resulted from the world depression which had been caused by an increase in production during the war, collapse of agricultural prices, and the post-war credit bubble fuelled by the gold exchange standard. To the French policy-making establishment the gold exchange standard and open-market operations were coterminous both were inflationary and faulted the price mechanism. Depression was part of a natural Darwinian process which had to run its course until a new equilibrium was found. These views were particularly espoused by Clément Moret, Governor of the Bank from 1930-35.

This thesis makes clear that although the Bank has often been accused of undermining governments of the left and centre this accusation is probably not founded, rather the Bank saw as its main function the defense of the gold franc.

The Bank and the majority of the French political establishment felt that if the gold franc were abandoned governments would follow the path of least resistance and monetise the deficit. Once this avenue was opened further devaluations would offer governments the prospect of enjoying the profits realised on the revalued gold reserves of the Bank. There would be no end to the financial rout. In the event the financially orthodox were proved right.

In the circumstances why couldn't France have devalued as the UK had done? The answer is straightforward, financial crisis masked a deep political cleavage which would have prevented a political coalition from reaching a necessary consensus on accompanying fiscal measures. That political cleavage was made worse by the perverse policies forced on French governments as a result of the increasing over-valuation of the franc does not detract from this judgment.

It is our judgment that French monetary and economic policy was characterised by failure in the 1930s. This applies in particular to the Gold Bloc whose importance should not be over-emphasised. France clearly wished to maintain this gold currency bloc to increase diplomatic pressure for an eventual return to gold. French policy-makers remained convinced that British agreement to such an accord could eventually be obtained. We will show that this was a serious misjudgment. As far as relations with the US are concerned both France and the UK would rightly continue to mistrust US policy initiatives after the London World Economic Conference. Failure was also apparent in France's policy of deflation and when Laval's experiment was abandoned the Popular Front's policy of "*pouvoir d'achat*" was also found wanting. This reflationary attempt failed before its inconsistent objectives encapsulated in the electoral pledge imposed by the nature of the Popular Front coalition of, "*ni déflation, ni dévaluation*".

Our answer to the entreaty that France should have engaged in open-market policies during the later 1920s to reduce the gold avalanche (q.v., Hawtrey) a policy which Eichengreen (1985) has identified as the only one which could have had a significant impact in reducing France's demand for gold, is that it was misconceived and would have compromised the independence of the Bank. Had the Bank engaged in such activities in the 1930s in circumstances when the budget deficit continued to widen despite, and because of, efforts at deflation, open-market operations would have undermined the credibility of the Bank and made it harder for government to fund deficits. In the circumstances such action might well have forced the authorities to rely on the issue of Treasury bills with the risks of monetisation that this would involve. Therefore the Bank was probably correct in rejecting open-market policies. As to devaluation as a solution to the depression of the 1930s, when it came it did undoubtedly bring relief but the last bulwark guarding against financial instability had been removed. The recurrent political crisis which masked as a monetary one would remain unresolved. Reform of the state might have provided a solution, but even then it is an important tenet of our thesis that the degree of cleavage was such that even political reform might not have provided an answer in the short-term. Given the inter-action between monetary and political factors it may be that a simple suspension of the gold standard would have been the best solution, at least it would have protected the gold reserves.

Finally, this thesis should put paid to the view that French monetary policy was characterised by financial ignorance. On theoretical grounds this was not the case and contemporary British policy prescriptions advocating variously open-market operations and devaluation failed to take account of political factors and historical antecedents.

Chapter One, "The Political Context," provides an analytic overview of the French polity and the sources of political instability, which were the ultimate cause of France's continuous post-war budget deficits and concomitant fiscal crisis till the Poincaré stabilisation. The 1930s would see a renewal of political instability which weakened the franc. This climaxed in 1935, when governments had increasingly to monetise the budget deficit by means of indirect advances from the Bank of France, leaving the Popular Front to inherit an extremely unfavourable financial situation.

This chapter gives a broad insight into inter-war monetary and economic history, which cannot be divorced from the political and economic matrix from which it issued. In this context, it is important to realise that it was not only the electoral system but the very nature of the historical and cultural political divide which accounted for political instability. The ambiguous position of the centre groupings and parties of radical persuasion, caught between an espousal of the republican heritage and social values to the left, whilst largely endorsing fiscal orthodoxy, meant that any alliance with the socialists would always prove tenuous. A far left coalition with the communists proved more elusive given the reluctance of the communists to condone the bourgeois system, such an alliance would have alienated many within the radical party. It was only with the rise of fascism and the leagues in France, and the imprimatur of Moscow, that the communists agreed to join in the Popular Front created in 1935.

Alliances between the centre-right and radicals were also prone to instability, as the radicals for reasons of electoral expediency and a firmly held republican tradition did not wish to distance themselves too much from the left.

Chapter Two, "The Inter-War Monetary System," is introductory in nature. It aims to demonstrate that the pre-war gold standard, which was to constitute a constant referent for French policy-makers, was far removed from the text-book model. The latter in its crudest form represented the gold standard as though it were a pure specie standard, with little or no role for financial intermediaries. A better understanding of the gold standard's managed, partly discretionary nature, or at least of its socio-political underpinnings, could well have saved France from the costs which a rigid adherence to financial orthodoxy imposed. An important point to make in this context is the downward rigidity of wages (relative to the fall in prices) which characterised the inter-war world. This meant that adjustment towards some form of equilibrium, rather than being smooth, consisted of destabilising quantity shifts, e.g., unemployment. Falling economic activity reduced government revenue, and attempts at balancing the budget had perverse and self-reinforcing macro-economic effects. The ensuing fall in prices raised real interest rates and indebtedness, exacerbating difficulties of economic adjustment. The inflexibility of the nominal wage-price framework was in part due to the more prominent role played by parties self consciously representative of working class interests in parliament, after the First World War.

Chapter Three, "French Monetary Policy Up to the 1933 World Economic Conference: A Comparative Perspective," examines war finance and its legacy of debt over-hang, particularly of short-term unfunded debt, and the post-war habit of carrying some 50% of government expenditure off-budget. A comparative section on British war and post-war finance demonstrates that French budgets were less sound than British. This is followed by an examination of France's post-war foreign policy illusions and domestic political imperatives which determined that reconstruction expenditure would be carried-off budget under the heading of "recoverable expenses" to be serviced by reparations payments. The Ruhr fiasco marked the end of this illusion, which had been the premise of early post-war budgets. Financial crisis continued until the Poincaré stabilisation in 1926. This chapter will take us through to the onset of depression and deflation.

Understanding earlier post-war French monetary experience up to the Poincaré stabilisation is crucial to comprehending the subsequent reluctance to devalue. Currency depreciation had become synonymous with inflation and it was felt that the *rentiers* could not be asked to make any further sacrifices.

Chapter Four, "Budget Deficits and Financial Instability," is thematic and takes a closer look at inter-war budgets, identifies the main source of deficits, and the political and economic difficulties that meeting these budgetary short-falls presented in the 1920s, in terms of building a consensus around the appropriate fiscal measures to adopt. In the 1930s difficulties were compounded by a deflationary macro-economic environment imposed by the fixed gold parity and exchange dumping as sterling and later the dollar were devalued.

Chapter Five, "The Nature of Financial Orthodoxy," is also thematic and demonstrates that the orthodox financial view was part of a well-articulated philosophical (viz.,methodological individualism), ethical (the sanctity of contract) and economic model (Manchester liberalism) which finds its contemporary resonance in Thatcherism and supply-side economics. The reluctance to embrace devaluation was a reflection of these beliefs as well as a theoretical understanding that devaluation would lead to imported inflation, and the post-war French experience which attributed inflation to a depreciating exchange.

Chapter Six, "The Gold Bloc: A Defensive Currency Pact," is divided into various specific sub-headings. The first examines the negotiations to secure a currency stabilisation agreement before and during the World Economic Conference, held in London in June-July 1933,- though as yet stabilisation had not become an explicit euphemism for an internationally agreed French devaluation. This section traces the reasons for which the Conference failed, resulting, as it did, in the formation of the Gold Bloc.

The second section examines the Gold Bloc and the monetary agreement which underlay it.

The third section analyses the attempt to give the Bloc concrete economic form by means of a trade agreement. The next two sections reveal the extent to which the most favoured nation clause (MFN) and fear of retaliation acted as impediments to trade liberalisation within the Bloc. They also point to the difficulty of a process of economic liberalisation in a depressed economic environment in which producer groups become more vocal and politically effective.

The last section deals with the discussions held ahead of Belgian Prime Minister Theunis's arrival in Paris in March 1935, to announce the forthcoming Belgian devaluation and the last-ditch and half-hearted measures considered by French policy-makers to stave this off. After the Belgian devaluation the Gold Bloc only proved a holding operation, though Laval would make one last spirited attempt at deflation by decree.

Chapter Seven, "The Devaluation Campaign," is thematic and examines the devaluation campaign. This began in earnest in the media, in 1934, when Reynaud gave the legislature a stark choice in a parliamentary debate, between a well prepared and deliberate devaluation, with an appropriate fiscal package, or being forced into devaluation by a run on the currency with all the attendant dangers.

Chapter Eight, "Negotiating Stabilisation (1934-36) and the Tripartite Agreement," chronicles official, secret, attempts to secure a stabilisation agreement from 1935-onwards. Chapters Seven and Eight reveal a significant contrast between the public media campaign largely opposed to devaluation with the strong support of most of the French political class, which remained to the end supportive of deflation and the fixed exchange rate regime and confident of its viability, and internal policy documents which demonstrate clearly that officials were aware very early-on that unless the UK or the US effectively joined the Gold Bloc it would not last. After the Belgian devaluation it was realised that it would be only a matter of time before a French devaluation. This chapter will examine various official *démarches* aimed at securing either, or both, US or UK agreement to a currency stabilisation package, which was understood to comprise a Gold Bloc devaluation. As the title of the chapter suggests it is divided into two distinct sub-headings.

Chapter Nine, "Monetary Policy in the Gold Bloc Period," examines French monetary policy in the period 1933-36. The emphasis is particularly on the period 1935-36 which was marked by an increasing financial crisis caused by the departure of Belgium from the Gold Bloc, increasing budget deficits, and the difficulties of funding borrowing with the twin prospects of devaluation and a Popular Front electoral victory.

By 1935 centre-right governments were resorting to "*avances occultes*," i.e., indirect advances from the Bank of France, and borrowing by para-statal organisations (reducing direct calls on the government budget) to compensate the worsening fiscal position. Indirect advances might take the form of agreeing to rediscount commercial bills held by banks which would use the proceeds to buy government securities, or pledge to rediscount any Treasury bills that banks and para-statals might hold in portfolio. The government's fiscal position was undermined by falling revenue, due to deflation, the need to re-arm, and the difficulty in further reducing budgetary expenditure. Government had to increasingly relax the rules on Treasury paper rediscountable at the Bank of France. Again the incoming left-wing administration, as in 1924, inherited a rapidly deteriorating fiscal and monetary situation.

The second section of this chapter looks at the devaluation debate in parliament between 28/9-1/10/36. This sheds a great deal of light on the reasons for which previous governments had failed to devalue, namely the need for an explicit international exchange rate agreement, backed by a commitment to return to gold. Opposition parties in both chambers, and even some radicals who nominally supported the government, spoke-out against the lack of accompanying fiscal measures and the fact that rather than retrench, the government was increasing expenditure. Others were critical of measures to tax gains realised on gold and foreign exchange, arguing that this would reduce any capital inflow following devaluation. Many of these critics were vindicated by the subsequent turn of events and serial devaluations, which marked the rake's progress of the franc in the later 1930s, though, by then it was too late as government expenditure was swamped by the budgetary exigencies of re-armament expenditure.

Chapter Ten, "Did France Destabilise the International Monetary System: The Maldistribution of Gold and the Open-Market Policy Controversy," examines the case put by the British, in particular, that France contributed to destabilising the international monetary system during the early inter-war years and that the maldistribution of gold was evidence of this (see Hawtrey). This British view does not fully take into account French domestic legislation and currency experience. I also examine the related argument that France could have offset the world deflationary effects of gold inflows during the period 1928-32, which effectively sterilised a significant proportion of world liquidity, through open-market operations (see Eichengreen, 1985). I also analyze the related proto-Keynesian argument that the Bank of France could have offset the deflationary effects of gold outflows through open-market operations during the latter-half of the 1930s.

The arguments on both sides will highlight the differences in interpretation between French analysts and their British and American counterparts on the causes of the depression and appropriate policy action. The French argued that the causes of the depression lay in real factors, viz., over-production, and an artificial credit bubble which was partly responsible for over-production and delayed adjustment to equilibrium conditions. Therefore, a return to normalcy would require a deflation of prices and production until a market clearing equilibrium could be found. The British view was that over-production had depressed prices and that the deflation of prices had depressed output and demand, this was compounded by downwardly inflexible nominal wages. British economists, however, had learned the political and social costs of deflating the nominal price level. Better to restore equilibrium by devaluing and allowing wholesale prices to rise, thereby restoring equilibrium between retail and wholesale prices (see Hawtrey). These analyses led to radically different policy prescriptions, viz., the advocacy of continued deflation by the French and reflation by British economists.

The differences between the British and French on the use of open-market policies illustrate a failure to understand, on both sides, the very different historical characteristics of British and French capital markets in particular, i.e., the British being credit driven and the French monetary system essentially based on cash transactions (see Bouvier) and characterised by a historically high rate of domestic savings. The interests of small savers played a significant political role in the policy of the radicals and radical-socialist party in parliament. French policy-makers had an abhorrence of anything smacking of managed money (*monnaie dirigée*), such as open-market operations. Essentially the French political and economic class was firmly wedded to a real bills doctrine which paradoxically, given the British nineteenth century debate, stemmed from strongly held orthodox financial beliefs.

Our study makes French currency experience, much castigated by British commentators at the time, more understandable. Chapter Three illustrates clearly that British and French monetary policy were in a sense mirror-images. Britain choosing to adopt a fixed and over-valued exchange rate commitment in the early post-war years for a set of philosophical, ethical and economic reasons, not dissimilar from those which explained French policy-makers' stance during the latter-half of the 1930s. In both cases the costs imposed by a fixed exchange rate regime were a set of perverse macro-economic policies which discredited the very political and economic system which they aimed to maintain, and at considerable social and economic cost. The lessons of the past are no less applicable today.

CHAPTER 1

THE POLITICAL CONTEXT

"Il résulte donc par cet exposé qu'il n'y a pas de trésors qui suffisent à un gouvernement déréglé, que le salut d'un Etat n'est attaché qu'à la sagesse de le conduire, et pareillement sa prosperité, son bonheur, la durée de sa gloire et de sa prépondérance sur les autres."[1]

This chapter analyses the most salient features of the inter-war political system. It will not delve in much depth into the specific features of any single government coalition, but rather draw with a broad brush the underlying features of the inter-war French polity.

The nature of the political institutions and, crucially, the balance of political forces were a significant determinant of the recurrent financial crises of the period.[2] The budget deficit which was so often monetised, was but a proximate cause of inflation and financial crisis. The ultimate cause was the inability to construct a strong enough coalition of interest groups to address the fundamental issue, namely the fiscal crisis of the state, and to build a consensus around measures to remedy it.[3] This is why a political and economic approach

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[1] *Duc de Saint-Simon*, Mémoires, 1714-15, *Tome XI*, p.243 (Ramsay ed., 1978). Saint-Simon on having been offered, *les finances* by the Regent, *Duc d'Orléans*, refused and penned this reflection on the state of France's finances. These appear particularly apt to the state of France throughout the inter-war years. Her huge gold hoard in many ways served to mask the underlying monetary instability which it faced in the 1930s.

Jèze attributed speculation, i.e., foreign exchange crisis, to the disorder in the public finances. The ultimate determinant of this being the political system which resulted in a recurrent fiscal deadlock. Quoting Jèze in reference to the gathering exchange crisis of 1935, but which could just as well apply to the period up to the Poincaré stabilisation, *"Mais la spéculation n'est qu'un effet du désordre financier, lequel a été amené par le régime politique."* in, Journal des Finances, 31 May 1935, from Bank of France *archive*, file: *Politique Monétaire 1935 (presse)*, 7ième E69.

[2] see Germain-Martin who attributed the instability of the radical governments from 1932-34 to the inability to secure the passage of a fiscal package through parliament.

[3] Quoting Eichengreen (Golden Fetters, p.300), "in France, Belgium, Italy, and Poland, and in the Central European countries...inflation had been symptomatic of the inability to achieve a consensus on the level of public spending and the distribution of taxes. It had been the market's way of reconciling incompatible claims. But inflation had redistributed income from creditors to debtors, polarizing society into competing factions dominated by the propertied and working classes. Failure to resolve the distributional conflict and control inflation had allowed political instability and financial turmoil to persist for nearly a decade. Compromise over the distribution of income and the burden of taxation had been achieved only at the end of a long, debilitating process." Though this extract appears to encapsulate France's pre-stabilisation inflationary experience our only criticism of Eichengreen's analysis rests on his reference to inflation as being the mechanism by which the

is essential to understand the inter-war French monetary experience. As, indeed, is a knowledge of financial orthodoxy essential to comprehend government economic policy.[4]

In the same vein the question of French devaluation during the period 1935-1936 cannot be divorced from the international context as well as the balance of political forces and opinion domestically.[5]

THE NATURE OF THE FRENCH POLITY:

The constitution of the Third Republic provided for a bicameral legislature and a President elected for seven years by a joint assembly of both the Senate and Chamber of Deputies meeting in a National Assembly (*Assemblée Nationale*) at Versailles, the President being elected by an absolute majority. The Senate was elected indirectly by colleges composed of regional, local and parliamentary constituency representatives.[6] The senatorial mandate was nine years, with a third of the Senate re-elected every three years. Senators had to be over forty. The lower house, the Chamber of Deputies, was elected for four years. Bills could be introduced in both houses, but finance bills had to originate in the Chamber of Deputies. In theory the lower house was pre-eminent,[7] but the Senate gradually increased its power. This would later lead to institutional deadlock, though in some respects this was more apparent than real, as the Chamber might support a government knowing full well that it would fall before the Senate. This allowed parties within the Chamber, which still nominally supported the government, to avoid blame whilst preparing a political realignment.

The institutional instability was greatly exacerbated by the decline of presidential power. In theory, the president could dissolve the Chamber of Deputies, with the approval

market reconciled competing interests over the relative distribution of costs relating to any given post-war financial settlement (later enshrined in the level of stabilisation against gold - see Eichengreen), it was emphatically not a market driven process but rather reflected the lack of a political consensus on the issue as a result of which government adopted the least cost method, viz., issuing short-dated Treasury bills and printing money.

[4] see chapter 5 of this thesis.

[5] see chapter 8 of this thesis.

[6] see Mayeur.

[7] Though there was some dispute over the interpretation of the constitution - see Middleton (1932).

of the Senate, and thus open the way for a new parliamentary majority, or a renewed electoral mandate in favour of a specific political agenda. However, this authority was only used once on May 16th 1877 by President Mac-Mahon. The ensuing elections disavowed him and dissolution fell into desuetude, and attempts to re-assert presidential authority under Millerand (1920-24) led to his resignation. It was also frequently the case that the presidency, in the inter-war years, would go to a lesser known political personality rather than a forceful character, - neither Clémenceau, nor Briand secured the office. Siegfried (1956) made the point that a president who presided rather than governed, as in the US, was preferred.[8] However, Siegfried (1956) pointed out that the President was more powerful than the British sovereign as weak party discipline and the existence of relatively independent and politically prominent figures gave the head of state greater autonomy to choose among political personalities to form a government. Nevertheless, the supremacy of the Chamber (rather than two organised parties within parliament, as in the UK) was an essential characteristic of the Third Republic.[9]

The *de facto* abandonment of the power of dissolution meant that the inter-war polity was characterised by fixed term parliaments with no mechanism for the executive to appeal directly for a mandate outside the normal cycle of elections. The fact that the Chamber could not be dissolved increased the willingness of parliamentary groups to bring down governments, safe in the knowledge that such action would not result in an early dissolution and electoral losses. The Chamber of Deputies and particularly the radicals, who, standing in the middle of the political spectrum, constituted an essential ingredient of any governing coalition, were jealous of their power and blocked any constitutional reforms which might have strengthened the executive.

It should be noted that the constitution of the Third Republic was Orleanist in nature, i.e., it embraced the division of powers and the role of President was tailor-made for a constitutional monarch. In fact had it not been for the intransigence of the *Comte de Chambord* and divisions between the monarchists France might well have had a constitutional monarchy.

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[8] Quoting Siegfried (1956), "*un président qui préside et non pas, à l'américaine, un président qui gouverne.*" (p.36).

[9] Quoting Siegfried (1956), "*Le régime de la IIIe République s'exprime essentiellement dans la suprématie incontestée du Parlement, et tout d'abord de la Chambre des députés.*" (p.39).

The original conservative conception of the constitution is betrayed by the role of the Senate. It provided for a solid 25% minority bloc of 75 life members who were elected by the Chamber.[10] The Senate itself would vote to fill any vacancies falling due amongst the life membership of the Senate. However, the system of life senators was abolished by constitutional amendment in 1884, though those still alive could retain their office. Life members were supposed to give the Senate a conservative bias, but owing to divisions between the monarchists, and the monarchists and bonapartists, this did not occur. The last life members disappeared by 1920.[11] The conservative bias was intended to be reinforced by the over-representation of the provinces in the Senate. Rebérioux refers to the Senate (in 1913) as the, "*Conseil des communes de France.*"[12] However, this was where the radicals found their support and in practice the Senate was dominated by radicals during the inter-war years. Nevertheless, the radicals in the Senate were characterised by adherence to financial orthodoxy.

Originally the radicals had opposed the Senate and wished to abolish it, but when it became apparent that it worked in their favour this proposal was forgotten.[13] The socialists were also opposed to the Senate as a dilution of popular sovereignty. Blum even suggested that should he form a government and find himself defeated in the Senate, and yet still enjoying a majority in the Chamber, he might refuse to resign. At one stage during the devaluation crisis of 1936 there were rumours that he might not back off some of the compensatory measures incorporated in his devaluation bill which were rejected by the Senate, in the process known as "*la navette*" whereby legislation had to be approved in similar form in both chambers. This did not occur, as Blum modified the bill, and later when his request for decree-making powers in the financial field were rejected by the Senate, in 1937, he resigned. However, by that stage it was clear that whilst he might still enjoy a nominal majority in the Chamber, it was but tenuous.[14]

Goguel (1937) underlined the orthodox views of the Senate, which preferred to reduce

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[10] see J.-M.Mayeur (1984).

[11] see Corcos (1932).

[12] see Rebérioux (1975) p.192.

[13] see Bourgin (1928).

[14] see Mayeur (1984).

expenditure in order to balance the budget without raising taxes, especially not income tax with its inquisitorial assessment. The Senate also favoured taxing agricultural land lightly, on estimated income. Goguel exonerated the Senate from the charge that it systematically brought down governments of the left. However, his analysis is too uncritical. The Senate contributed to blocking constitutional reform, e.g., Laval's proposed reforms which met the combined opposition of the radicals and socialists in the Senate,[15] and only agreed to delegating decree-making financial powers to the most financially orthodox governments, e.g., Doumergue in 1934 and Laval in 1935. The increased conflict, during the inter-war years, between the Senate and the Chamber of Deputies can undoubtedly be ascribed to the fact that the Chamber was increasingly to the left of the Senate and to the very orthodox fiscal stance adopted by the Senate. Aside from the specific instance of Laval's proposed electoral reform, in February 1932, the Senate was directly instrumental in the fall of governments of the left whose requests in the financial field were denied, viz., Herriot's first *Cartel* government (15/6/24-10/4/25), Blum's first (6/6/36-22/6/37) and second (17/3-18/4/38) Popular Front governments. Though it is true that, in all three cases, the governments were effectively moribund.

The Senate had gradually increased its political weight and first overthrew a government in 1896 when Leon Bourgeois' government fell on the issue of a proposed income tax.

One should also note that along with the increased authority of the Senate there was a decline in the influence of the presidency both of which made for increased institutional deadlock. The fact that the executive could not ask for a dissolution of the Chamber if it lost a vote before the Senate, or in the case of an inability to form a stable government, contributed to the instability of the French inter-war polity. Siegfried (1956) argued that the nature of the Third Republic was determined by the outcome of the struggle between the presidency and parliament which had left the Chamber of Deputies pre-eminent. Middleton (1932) argued that parliaments became effectively fixed term.[16] And that this accounted for

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[15] Mayeur (1984) p.293.

[16] see Middleton (1932).

the fissiparous tendencies and infinite flexibility of parliamentary groups,[17] particularly those gravitating towards the centre of the political spectrum, e.g., the radicals and the smaller *gauche radicale*.

INTER-WAR FRENCH POLITICAL PARTIES:

At the centre of the political spectrum stood the radicals who were divided into different tendencies. However, their common denominator was the republican lay state and a progressive social bent, and idealism in foreign relations. Amongst these groups the radical-socialists can most properly considered a party, whilst the *gauche-radicale* was a looser formation embracing more individualist personalities.

The radical-socialist party was a parliamentary party which rejected revolution and did not pretend to dogma, except when it came to the lay republic. It did not set predetermined bounds to reform. In political practice it proved eminently pragmatic. The great divide separating it from the new parties of the left was over the issue of individualism and private property, it still remained a progressive 19th century liberal party as opposed to the newer parties of the left which adhered to a collectivist ethos.[18] The radicals were yet further removed from the elitist communists who largely considered the parliamentary process a sham. Of course the socialist parties would have argued that it was an illusion to think that "progress" and private property would be ultimately compatible. The radicals supported private ownership, but wanted to see profit-sharing and worker participation.[19] The radicals considered themselves the heirs to the Jacobin tradition and the radical-socialist party defined itself as: *"le parti est populaire, laïque, national et social."*[20]

The radical tradition rested on individualism and those same (negative) political rights proclaimed in the *Déclaration des Droits de l'homme*, and rejected economic privilege (cf., the abolition of corporations (guilds) at the Revolution and the *"loi le Chapelier"*) it

[17] Quoting Middleton (1932), "In a Chamber bound to continue in existence until its mandate expires the mere liability to ministerial crises calls for elasticity in the distribution of Parliamentary forces. It militates against the notion of a two-party system and favours the formation of groups." pp.104-105.

[18] see Corcos (1927).

[19] see Bourgin (1928) p.137.

[20] see Corcos (1927) p.79.

conformed to what had been a progressive, essentially "bourgeois" agenda. However, with time and the advent of the collectivist socialist parties, which advocated positive rights (particularly in the economic field) the economic agenda of the radicals increasingly became identified with the right, whose own economic beliefs no longer represented agrarian interests but those of cosmopolitan capital, and liberal economics provided the ideological vehicle to promote these. In the political sphere, though, there remained a link between the two tendencies of the left, viz., radicals and socialists. Both considered themselves progressive modern parties, viz., secular. The fundamental irreconcilable contradiction between the socialists and radicals was that the liberal economic policies of the radicals found root in their underlying individualist political heritage. This set very clear bounds to the degree of co-operation which could exist between radicals and socialists, whilst any alliance between radicals and communist collectivism and revolutionary ideology would not be acceptable to most of radical persuasion.

A common feature of the radicals and communists was their shared internationalism. With the former this rested in the belief in the absolute verity of their individualist political ethics. These were considered intrinsic to man, hence their desire to find these enshrined in an international organisation and applied collectively among the nations (which had in the past served as the vehicle for the expression of these liberal political rights at a national level against despotism and the arbitrary), this explains their support for the League system. The communists similarly rested their internationalism on the assumption, as an absolute, of a collective international identity of interests between the working classes of all nations. These interests being represented and promoted by the first socialist state, viz., the USSR. For the communists Moscow was Geneva. One should note that both radicals and communists made claim to absolutist ethical principles, reflecting the transposition from the religious to the social sphere of monotheistic hubris.

The radicals supported the existing constituency-based majority electoral system. On fiscal issues they favoured direct over indirect taxation, and progressivity in its imposition, and capital taxation to help remedy the fiscal crisis of the state (a decision taken at the radical congress of 1925 held in Nice), though the party was divided over the latter issue, with Caillaux being one of the foremost opponents. The radicals were against monopolies and elements favoured an *économie dirigée* and "*planisme*."[21] As a foreign policy extension of their domestic policy support for the lay state (which was more akin to an ideological imperative or dogma) the radicals were in favour of severing diplomatic relations with the Vatican (which they did under the *Cartel* government). In the wider international context they favoured mediation through the League of Nations and a policy of reconciliation with Germany. The party was not well-disciplined though, and was split between left and right-wing tendencies, the left being close to the socialists.

The radicals were divided into the *parti républicain radical et radical socialiste* and the smaller radical groups such as the *gauche radicale*. In the 1924-28 parliament the *gauche radicale*, with 41 seats, constituted a crucial swing group.[22] In fact the *gauche radicale* were represented in all governments from 14/6/24 till 4/6/36. It was a small party with no more than 40 or 50 deputies. Amongst its more prominent members were L.Germain-Martin, L.Loucheur and Laurent-Eynac.[23]

The most prominent members of the radical-socialist party were E.Herriot, E.Daladier, A.Sarraut and M.Sarraut (the Sarraut brothers controlled the radical newspaper La Dépêche de Toulouse), Franklin-Bouillon, Jammy Schmidt, G.Bonnet, A. de Monzie, E.Clémentel, J.Caillaux and C.Chautemps. It was characteristic of the radicals that they should command such domestic and social ministries as, the Interior, Education (*Instruction Publique*) and Agriculture.[24] The radicals typically controlled these ministries because of the power of patronage and political influence that went with them.[25] The Minister of the Interior appointed the prefects, whilst the Ministry of Education (*Instruction Publique*) was considered the ideological arm of the radical (secular) state.[26] The paradox is that the radicals having been instrumental in the separation of the Church and State had now bound

[21] see Jackson (1985).

[22] Mayeur (1984) p.277.

[23] Olé-Laprunne (1962) pp.205-206.

[24] Olé-Laprunne (1962).

[25] see Tardieu; and D.Halevy.

[26] see Halévy (1934).

the state and the educational establishment together[27] as the essential corner-stone of the lay state (some might say its ministry of propaganda) leaving open the contention that their motives were just as self-interested as the role which the Catholic Church had been charged with exercising before.[28] This of course opens the intractable and value laden question as to whether the lay state, and more particularly dogmatic secularism (as often practised in France, even to this day), is a form of cultural hegemony or a fundamental and absolute tenet of an "open-society." The radicals defended secular education on the grounds that it was the basis of freedom of conscience, the cornerstone of "reason."[29]

The radicals can best be defined as a progressive humanist party. It rested its political ethics on the meliorative possibilities of man and was essentially individualistic. It claimed no enemies to its left, but as the *Alliance Démocratique* pointed out its underlying philosophy was antithetical to the collectivist ethos which animated the socialists (SFIO) and the communists (SFIC). D.Halévy (1934) argued that the radicals constituted the ante-chamber which would usher in the socialists.

The radical-socialists rejected the rhetoric and practice of class conflict and considered themselves, in their very essence a parliamentary party. The following quotation from the 1907 programme of Nancy, which is generally considered to be their fundamental charter, demonstrates the distance between them and the Marxist parties: "*...il se refuse à établir, même théoriquement, entre les citoyens, des classes en lutte les unes contre les autres. Parti d'action sociale parlementaire, il réprouve toute manifestation violente que ne justifierait pas une atteinte grave à la Constitution républicaine et aux volontés de la Nation.*"[30]

The Senate was dominated by conservative radicals,[31] grouped within the gauche démocratique. Its most prominent members were Caillaux and Malvy, both of whom had been charged and found guilty of dealing with the enemy during the war and reprieved by

[27] see Thibaudet (1927).

[28] Tardieu (1936) inveighing against the new dogma quoted Emile Combes, "*A la foi qu'enseigne l'Eglise, une autre foi a été substituée.*" p.89.

[29] see Corcos (1927).

[30] Quoted in Bourgin (1928) p.137.

[31] Quoting Schlesinger (1974), "Throughout the Republic, Radicals sat with independent moderates in the Senate's largest group, the Gauche démocratique, which was generally sympathetic to conservative moderate rule." p.490.

the *Cartel* government. It is interesting to note that the radicals who originally opposed the Senate became staunch guardians of the constitutional order which came to serve their interests so well. The radical senators were protective of the influence of the Senate and blocked Laval's proposed constitutional reforms in 1932. The left were opposed to a strengthened executive after the experiences of 2nd December 1852 and the advent of the Second Empire. This dislike was reinforced by the events of May 1877 and the Boulanger crisis of the late 1880s, which added to the reluctance of the left to study reform proposals aimed at strengthening the executive.

To the centre-right of the political spectrum was the *Alliance-Démocratique* (its full name was the *Alliance Républicaine Démocratique*). Amongst its most prominent members were P.Reynaud, R.Poincaré, L.Barthou, C.Chaumet, R.Péret, H.Chéron, P.Doumer, J.Barthélemy and P.-E.Flandin. The party was the leading force in the constitution of the *Bloc National* after the war. Most of its representatives in the Chamber of Deputies sat within the groups: *Gauche Républicaine Démocratique, Gauche Indépendante,* and, *Républicains de Gauche.*[32] In the Senate its members sat in the: *Union Républicaine* and some few within the *Gauche Démocratique*. In 1922 the Secretary General of the *Alliance Démocratique* defined his party as revolving round "*laïcité et liberté économique,*" viz., laicism and economic liberalism.[33]

One should note, in this regard, that subjectivism (scepticism), arguably the defining principle of liberalism, goes hand-in-hand with political and economic liberalism and is at odds with the moral absolutism of the Church.[34] Marxism with its emphasis on positivism and scientistic inevitabilism is in fact closer to a Thomist perspective than liberal teachings, though one should recall that liberalism as an "absolute,"[35] which was the essence of the radical and republican world-view, is nothing but another "ism" (q.v. Michael Oakeshott). It is interesting to remark that Marxism is suffused with the intolerant dogma of monotheism,

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[32] see Bourgin (1928) p.92.

[33] see Bourgin (1928).

[34] Here one should make a clear distinction between Voltaire's scepticism and Rousseau's enlightened "absolutist" reason which finds its essence in the hubris of monotheism, and full political expression in Stalinism.

[35] Similarly the dogmatic characteristic of what is the dominant liberal political model arises from its pretence to rest on positive principles, rather than scepticism.

often compounded by the jesuitical fervour of the proselyte (Gore Vidal has tellingly dubbed Marxism a Christian heresy).[36]

The *Alliance* was conservative, but not reactionary and refused to entertain relations with monarchists and clerical reaction. It was fully committed to economic liberalism which it considered rested on the political liberalism announced in 1789.[37] The socialists on the other hand considered the political revolution of 1789 as a first step towards a process of economic liberalisation and emancipation based on a fundamental redrawing of property relations.[38] In the fiscal field the *Alliance Démocratique* favoured retrenchment through reductions in expenditure and opposed a capital levy or tax. It supported the income tax, but was opposed to an inquisitorial assessment. The *Alliance* supported Poincaré's foreign policy under the *Bloc National*[39] and denounced the Locarno policy of conciliation.[40]

Among the more prominent members within the républicains de gauche, were F.Piétri and G.Leygues.[41]

To the right of the *Alliance* stood the Fédération Républicaine, its full name was: *La Fédération Républicaine de la France*. Amongst its most prominent members were: L.Marin (its president); G.Bonnefous (a vice-president); François-Marsal; de Lasteyrie; and François de Wendel. On economic issues the *Fédération* supported Manchester liberalism. It wanted the sanctity of private property (one of the fundamental, and often ignored, principles of the

[36] In this context it is worth quoting an extract from P.Wiles's inaugural professorial lecture. "What prevents people, other than the enlightened leadership, from recognising it is corruption, superstition, relics of the evil past. The march of right reason is inevitable, so freedom, being knowledge of right reason, is the acceptance of necessity. The totally enlightened society is thus unanimous. Differences of opinion indicate only imperfect enlightenment; they must be resolved not by majority rule or mere voting but by education or even purges. There are no "contradictions," i.e., conflicts of interest, in the enlightened society. Every individual's interest is, and is seen to be, reconciled by reason to the general will."(Wiles, 1967, p.17). In this neo-Calvinist world the recipients of revealed reason, the engineers of society, the high priests of secularism: the sociologists, Marxists, and teachers, act as moral and political guides; just as the economy is planned rationally by engineers. Gosplan is Rousseau's "General Will",- the degenerescence of rationalism. Wiles is clearly imbued with Hayek and Oakeshott.

[37] see Bourgin (1928) p.95.

[38] That is an inevitabilist Hegelian progression from negative political rights, achieved in 1789, to the establishment of positive economic rights and entitlements, the beacon here being October 1917.

[39] see Bourgin (1928).

[40] see Corcos (1927).

[41] see Levine (1925).

1789 Declaration of the Rights of Man) to be protected by a supreme court. It also wanted to circumscribe parliamentary initiative in the field of expenditure. On political issues it supported extending the suffrage to women and an electoral system based on pure proportional representation and preferential voter selection of candidates appearing on electoral lists. It is interesting to note that it was the left (the radicals in the Senate) which blocked the extension of the suffrage to women (it was only granted after the Second World War). The radicals were opposed on the grounds that women would be more susceptible to twin pressure exercised by the clergy: from the pulpit, and in the confessional. Tardieu pointed to the paradox that the radicals, who had blocked the extension of the suffrage to women, were in fact acting in conformity with the attitude of the church!

The greater tolerance of the *Fédération* compared to the so-called progressive parties of the left was also apparent in its opposition to the monopoly of education being exercised by the state: *école unique*. This meant that the *Fédération* was at odds with the radicals over the defining principle of radicalism: the lay school as the essential building block of the "rationalist idealist" principles governing the republican state. The *Fédération* supported allowing priests and religious orders to teach. The *Fédération* was opposed to fiscal surcharges and advocated expenditure reductions, similarly it rejected forced conversion of the state debt. It opposed "political taxation" and *"l'état escroc,"* what we would now dub the pocket money polity. Members of the *Fédération Républicaine* sat within the group: *Union Républicaine Démocratique* in the Chamber of Deputies, this group was also known as the "Groupe Marin."[42] The *Fédération Républicaine* was opposed to Locarno and supported a maximalist policy with regard to the implementation of the Treaty of Versailles.

Between the radicals and the socialists stood the *Républicains-Socialistes* (the full party name was the: *Parti Républicain-Socialiste et Socialiste Français*). Its members were independent and held to the Jacobin patriotic tradition. They emphasised the indissoluble link between socialism and the republic.[43] They therefore differed from the Marxist parties by rejecting their internationalism and the accompanying desire to overthrow the republic, though in the case of the SFIO its internationalism was limited, witness the split over the question of joining the Third International. In the case of the SFIO its avowed desire to

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[42] see Bourgin (1928).

[43] see Corcos (1927).

overthrow the bourgeois regime might well have gone the way of clause four in the British Labour party's constitution, an essential but largely inoperative talisman. The republican-socialists also reflected the rich tradition of independent thought within the French socialist intellectual tradition, as opposed to its more collective German and Asiatic manifestations. The party was not a well disciplined parliamentary party.[44] The party argued that property relations should reflect social utility (whatever that means) and claimed to be the party of the Saint-Simonists.[45] As such it cannot be considered a properly Marxist party. It formed the group: *Républicains-Socialistes* in parliament. Its most prominent inter-war members were A.Briand, P.Painlevé, M.Violette, and Paul-Boncour. The party was opposed to the *taxe sur le chiffres d'affaires* (turnover tax) and supported a progressive income tax with a heavier burden falling on unearned income.

To the left of the political spectrum stood the Marxist parties: the *SFIO (Section Francaise de l'Internationale Ouvrière)* and the *Communist party (Section Francaise de l'Internationale Communiste)*. The parties split at the congress of Tours, in 1920, with the majority aligning itself to Moscow's *diktat* within the Third International and forming the Communist party. This group took control of the party's newspaper: *L'Humanité*. The minority which refused to follow, could not accept the control which Moscow wanted to exercise: vetting and purging members and control over policy.[46] The communists refused to support national defence of the bourgeois state which was a major stumbling block in any alliance with the radicals. This was overcome with the Franco-Soviet pact of 1935. The SFIO, headed by L.Blum, established its own newspaper: *Le Populaire*. It retained its adherence to the Second International along with the British Labour party.

The unions split along similar lines as the socialists, after the congress of Lille of 1922,[47] with the CGTU (*Confédération Générale du Travail Unitaire*) breaking away from the CGT (*Confédération Générale du Travail*). The name CGTU implying as it does that it was representative of the whole union movement is a clear illustration of the mendacious corruption of language used for propaganda purposes by communists (see Hayek). The

[44] see Bourgin (1928).

[45] see Bourgin (1928).

[46] see Mayeur (1984).

[47] see Bourgin (1928).

CGTU aligned itself closely to the Communist party and Moscow, whilst the CGT maintained the traditional syndicalist independence from political parties enshrined in the 1906 Charter of Amiens.[48] The socialists (SFIO) recognised this traditional independence.[49] The CGT was headed by L.Jouhaux who, according to J.Rueff, was instrumental in helping to decide Poincaré in favour of *de jure* stabilisation of the franc in 1928. As part of the *Rassemblement Populaire* policy, which would later issue in the Popular Front, the CGT and CGTU were reunited in 1935, and the CGTU was essentially absorbed back into the CGT.

If one were to describe and differentiate both Marxist parties one could usefully suggest that the SFIO was a Marxist party, whilst the Communist party, headed by Maurice Thorez, was more properly a revolutionary Marxist-Leninist party. Amongst rising stars of the communist party was Jacques Doriot who later founded the fascist: *Parti Populaire Français*. Among the more prominent members of the SFIO was Vincent Auriol, who would become Finance Minister in the first Popular Front government and first President of the Fourth Republic. And among its younger deputies was Marcel Déat who would form the neo-socialist tendency and later create the fascist: *Rassemblement National Populaire*.[50]

Blum would make clear his distance from the communists by making a distinction between the conquest and exercise of power.[51] The latter was the mandate which he considered had been granted to the Popular Front in the elections of 1936. This constrained it to act within legality and the existing political and economic nexus, though the SFIO, in theory, still remained a revolutionary party arguing that political democracy could not be divorced from economic democracy and that by definition within the existing political system true democracy could not be realised. In a typical essay in casuistics it was therefore argued that a temporary dictatorship of the proletariat would be necessary to institute real democracy through a radical alteration in property relations. It therefore endorsed a departure from bourgeois legality,[52] though, in practice Blum's government worked within the constitution,

[48] see Bourgin (1928).

[49] see Bourgin (1928).

[50] see Kedward (1969).

[51] see Lacouture (1982) p.175.

[52] see Corcos (1927).

one should not forget the party rhetoric and the shock impact which this must have had on the bourgeoisie. The socialists (and the communists) considered 1789 as the first step towards emancipation, whilst the political liberals, viz., radicals, *Alliance Démocratique* and *Fédération Républicaine*, considered the principles of 1789 as determining a set of fundamental and absolute principles which could not be departed from.

Both Marxist parties were well organised and disciplined, particularly the communists. It can be argued that they owed this greater discipline to their underlying collective ethos as opposed to the liberal individualism underlying the philosophical and political ethics of the bourgeois parties. Marxism is, in a sense, incompatible with free liberal thought resting as it does on iron economic laws which dictate in a determinist and pseudo-scientific fashion political discourse. Marxism is a denial of free will of which liberalism is the political manifestation. In that sense it is fundamentally at odds with radicalism which subscribes to the "revolutionary" individualist ethos (q.v., the 1789 Declaration of the Rights of Man). The common denominator between the socialists and radicals had originally been the entrenchment of the lay republican state, once this had been obtained the radicals found themselves effectively at odds with much of the marxist parties' political agenda.

Both Marxist parties were wedded to class conflict. The SFIO wanted to revise the Constitution and abolish the Senate and introduce proportional representation to preclude immoral coalitions which occurred under the constituency based system with a second round run-off,[53] as did the system of proportional representation with a majority premium. The socialists supported a capital levy and consolidation of the floating debt, either through a forced conversion or a hypothecated tax resting on the revenue from a *régie* (state monopoly), such as tobacco. It also supported nationalisation of monopolies (as did the radicals) and international disarmament and the reduction of military expenditure.[54] The Marxist parties were also opposed to the liberal concept of representative parliamentary democracy and considered that the deputy, as a delegate of the party, should be its instrument in parliament and vote according to party directives. Neither party was willing to vote the credits which bolstered the bourgeois state, viz., military credits, the colonial budget, secret

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[53] see Bourgin (1928).

[54] see Bourgin (1928).

funds and the budget as a whole.[55]

The parties divided into the following groups within the Chamber of Deputies during the five parliaments of the inter-war years:

	1919
Entente républicaine démocratique (forerunner of *Union républicaine*)	183
Gauche républicaine démocratique	96
Parti radical et radical-socialiste	86
Parti socialiste SFIO	68
Républicains de gauche	61
Action républicaine et sociale	46
indépendants	29
Républicain socialiste	26
non-inscrits	21

Amongst these groups Bonnefous identifies the following as broadly supporting the *Bloc National*: *Entente Républicaine Démocratique*; *Républicains de Gauche*; *Action Républicaine et Sociale*; *Indépendants*. (see Bonnefous, 1962, vol.3, p.90).

		1924	1928
Communistes		26	12
Socialistes SFIO		104	100
Républicains socialistes	}		18
Socialistes français	}	44	13
Indépendants de gauche	}	15	
Radicaux et radicaux socialistes		139	125
Gauche radicale		40	53
Démocrates populaires		14	19
Gauche unioniste		--	18
Gauche républicaine démocratique		43	--
Républicains de gauche		38	64
Union républicaine démocratique	}	104	102
Action démocratique et sociale	}		29
non inscrits		29	38

Source: Bonnefous 1962, vol.4., p.256.

[55] see Corcos (1927).

	Before 1932 election	After 1932 election
Conservateurs	8	5
Union républicaine démocratique	90	76
Indépendants	26	28
Républicains de gauche	101	72
Démocrates populaires	19	16
Radicaux indépendants	90	62
Radicaux socialistes	109	157
Républicains socialistes	32	37
Socialistes	112	129
Socialistes communistes	5	11
Communistes	10	12

Source: Bonnefous (1962) vol.5. p.120.

Parliamentary groups after the 1936 election:

Groupe communiste	72
Goupe socialiste	147
Groupe de L'Union socialiste et républicaine	25
Groupe de la gauche indépendante, du Parti C.Pelletan, du parti frontiste, du parti de L'Unité prolétarienne, du parti de la Jeune République	26
Groupe radicale-socialiste	106
Groupe de la gauche démocratique et radicale indépendante	32
Groupe de l'Alliance des républicains de gauche et des radicaux indépendants	44
Groupe démocrate populaire	13
Groupe indépendant d'Action populaire	16
Groupe des républicains indépendants et d'action sociale et Groupe agraire indépendant	38
Groupe des indépendants républicains	12
Groupe de la Fédération républicaine de France	59
non-inscrits	8

Source: Journal Officiel 9/6/36 in Bonnefous (1962) vol.6, p.437.

THE SENATE:

C.Girard in an addendum to Corcos (1932) provided a useful sketch of the various tendencies within the Senate and the gradual change in its composition. Girard pointed out that though the political configuration of the Senate was slower to change than that of the Chamber due to the staggered renewal of the Senate, which had been deliberately aimed at giving the polity a more stable counter-poise, nonetheless there was a significant shift to the left over the twelve year period which he reviews.

The whole Senate was renewed over the period 1920-21, as the war had postponed re-election of categories B and C and category A was up for re-election in 1921. There were now 314 seats, fourteen new ones for the recovered territories of Alsace-Lorraine. The composition of the Senate which emerged from these various post-war consultations yielded the following groups: *Gauche Démocratique* 158; *Union Républicaine* 102; *Gauche Républicaine* 38; *Droite* 12. The left within the *Gauche Démocratique* (the group's full title was: *Gauche Démocratique, Radicale et Radicale-Socialiste*) had an absolute majority. The parties which fell within the umbrella of this group were: radical-socialists; republican-socialists; socialists and the *Gauche Radicale*. The *Union Républicaine* encompassed members of the *Alliance Démocratique* and the *Fédération Républicaine*. To its right was the group: *Gauche Républicaine*. The group: *Droite* tended towards monarchism. Elections which took place in 1924 and the effects of partial elections increased the left of centre majority with the *Gauche Démocratique* increasing the size of its group to 164 members.

However, some members of the *Gauche Démocratique* frequently voted with the right. As a result, and particularly after the election to appoint a new president of the Senate in June 1924 had secured the appointment of the candidate of the right (de Selves), the party decided to increase its discipline. A minority rump to the right of the group broke-off to form a new centre group the *Groupe de l'Union Démocratique et Radicale*." They were joined by some members of the *Union Républicaine*. The new group had 33 members. However, Girard argues that it strengthened the left by increasing its cohesion and the new group by detaching eleven members from the *Union Républicaine* had weakened the right. Girard equates the stance of this new group to that of the *Gauche Radicale* in the Chamber. The composition of the Senate was showing a gradual shift to the left. Girard gives the following figures for the end of 1924: *Gauche Démocratique* 157; *Union Démocratique et*

Radicale 23; *Union Républicaine* 88; *Gauche Républicaine* 30; *Droite* 10. The elections of 1927 which renewed the seats of category C senators produced further gains for the left with the *Gauche Démocratique* gaining three seats. The centre: *Union Démocratique et Radicale* won seven new seats. The *Union Républicaine* lost four and the *Gauche Républicaine* eight. The President of the Senate had lost his seat and the new incumbent was P.Doumer who belonged to the *Gauche Démocratique*. The 1927 elections saw the formation of a new senatorial group: *Groupe Socialiste* (SFIO), with fourteen members. Previously its six senators sat within the *Gauche Démocratique*.

This inflection towards the left would continue and the partial renewal of 1929 increased the socialists' representation. For 1932 Girard gives the following composition: *Groupe Socialiste* 16; *Gauche Démocratique* 150; *Union Démocratique et Radicale* 34; *Union Républicaine* 71; *Gauche Républicaine* 20; *Droite* 9. There were 12 senators not registered with any group. As Girard demonstrates it is clear that over the period which he reviews there was a very significant shift towards the left within the Senate. This trend was continued in the subsequent senatorial elections with the entry of the communists and a further increase in seats for the *Gauche Démocratique*. Bonnefous (1962) gives the following figures: *Groupe Communiste* 2 (2); *Groupe Socialiste* 14 (14); *Groupe Gauche Démocratique* 163 (158); *Groupe de l'Union Démocratique et Radicale* 29 (27); *Union Républicaine* 58 (59); *Groupe d'Action Nationale, Républicaine et Sociale* 16 (16); members not registered with any group 31 (33). The figures which are given in brackets refer to the situation in 1938. It is quite clear from these figures that the Senate leant nominally to the radical centre-left and this explains its reluctance to endorse constitutional reform proposals which the radicals considered an attack on the parliamentary nature of the polity,- which it indeed was. Nevertheless, the Senate remained wedded to fiscal orthodoxy, witness the election of Caillaux as head of the Senate Finance Committee in 1932, which explains its refusal to grant decree making powers to Blum in the financial field.

The following table gives a breakdown of the electoral results of the five inter-war parliamentary elections to the Chamber of Deputies:

	1919		1924
Bloc National	338	*Bloc National*	229
Centre	75	*Centre*	47
Gauche	197	*Cartel des Gauches*	266
	---	*Communistes*	26
	610		---
			568

	1928		1932
Conservateurs et Fédération républicaine.	160	*Droite*	127
		Droite modérée	48
Radicaux indépendants et républicains de gauche.	147	*Démocrates populaires*	14
		Républicains socialistes	33
Radicaux-socialistes	120	*Gauche modérée*	72
Républicains-socialistes	47	*Radicaux socialistes*	151
Socialistes	100	*Socialistes*	130
Socialistes communistes	2	*Communistes dissidents*	10
Communistes	14	*Communistes agrariens*	0
Indépendants et divers	3	*Autonomistes et divers*	20
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	593		615

	1936
Front National	222
Front Populaire:	
Radicaux socialistes	109
U.S.R. et apparentés	56
Socialistes SFIO	149
Communistes	72

	608

Source: Soulier (1939) *L'instabilité ministérielle sous la Troisième République (1871-1938)*, pp.516-517.

THE ELECTORAL SYSTEM:

During the period under review (1919-39) France experimented with two electoral systems. Neither of which was characterised by greater stability, both political or financial.[56] The electoral law was modified in 1919 in favour of proportional representation.[57] The radicals accepted the reform in part because the attitude of the socialists precluded the play of *la discipline républicaine*[58] viz., supporting the best placed "left" candidate in the second round of elections under the old electoral law. The previous electoral law was based on a first past-the-post system and a second round should any candidate fail to secure an absolute majority in the first.

It is perhaps interesting to explore the debate over the form which the electoral system should take, as it demonstrates clearly how the nature of the electoral system in France (right up to the present day) has been dictated by matters of party partisan political expediency. Originally Gambetta (a nationalist radical in the Jacobin tradition) had favoured a system of proportional representation based on lists, as he felt that the constituency based system would favour candidates supported by local dignitaries (*notables*), whilst lists would allow the election to be fought on concrete issues and ideas, rather than local personalities.[59] Later A.Briand (an independent socialist) would attack the constituency based clientelist system as so many "*petites mares stagnantes*," viz., little stagnant pools.[60] However, Briand would be instrumental in blocking electoral reform before the war, as the existing electoral system worked well in the left's favour. The *Fédération Républicaine* and later the communists favoured proportional representation as a means of securing a more equitable parliamentary representation. The socialists (SFIO) also supported proportional representation, but were

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[56] Eichengreen has shown that a degree of correlation existed between proportional representation and the degree of post-war financial instability in several countries (see Golden Fetters pp.92-97). However, in the case of France the electoral law of 1919, though nominally based on proportional representation, lent a significant premium to a majority coalition. Hence, the landslide victory of the *Bloc National*. The fact that this coalition failed to find a solution to the fiscal crisis of the state is due to deeper social and political cleavage which we explore further in chapter one.

[57] see Goguel (1946) p.215.

[58] see Mayeur (1984) p.253.

[59] see Rebérioux (1975).

[60] see Rebérioux (1975).

willing to go along with the constituency based system as long as the alternative was a form of adulterated proportional representation.

André Tardieu and Daniel Halévy were particularly scathing in their attacks on the local constituency system which was based around small constituencies (*arrondissement*) and left the deputy beholden and captive of interest and pressure groups. It also explains the weak party discipline. The reason such instability is not apparent in the UK is the absence of two electoral rounds, which forces a pre-electoral coalition of interests around two broad parties, the essentially bi-polar nature of the polity around the Labour and Conservative parties is a product of a clearly defined political and cultural heritage, and voting for one or other of the candidates without too much regard for the individual in question reduces information costs.

In France part of the right was alienated from the political system and the polity had not enjoyed the same evolutionary constitutional stability.[61] In a way elements within the right in the Third Republic were alienated from the polity in the way that certain factions within the Tory party were in the generation after the "Glorious Revolution" of 1688.

Jackson (1985) has argued that the political instability during the inter-war period was not so much due to the electoral system, but rather to the existence of relatively fluid and loose political alliances.[62] Though it is possible that had the authorities stuck to the post-war electoral system of proportional representation (abandoned in 1927), which afforded a premium to parties winning an absolute majority and thus encouraged joint electoral lists, that this could, over time, have produced a concentration around two electoral blocs. As it happened the two elections fought under this system, in 1920 and 1924, did produce two dominant parliamentary blocs. In the first post-war parliamentary elections the centre-right parties formed the *Bloc National*. This was built around foreign policy objectives and against socialism. This alliance brought together most of the "bourgeois" parties on joint lists in an anti-bolshevik electoral campaign driven by Clemencist nationalism.[63] The radicals did not participate and presented their own lists. The split of the left vote, the cohesion of the centre-right and the reformed electoral system resulted in a significant victory for the *Bloc*

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[61] see Siegfried (1956).

[62] see Jackson (1985).

[63] see Middleton (1932) p.38.

National. The *Bloc*, which was determined to maintain the solidarity of the front-line, was dubbed the "*chambre bleu horizon.*" However, this alliance gradually fragmented.

The *Cartel des Gauches*, an electoral alliance of radical-socialists, *gauche radicale*, independent socialists (*socialistes-républicains*) and socialists,[64] which was victorious in the 1924 elections proved an even more heterogeneous and febrile bloc.

Despite the fragmentation of both the *Bloc National* and the *Cartel des Gauches*, with time the proportional electoral system might have produced two relatively homogeneous political parties, though this would still have left the communists marginalised, with the potential for instability for any left-wing bloc relying on their support. Siegfried (1956), though, in his comparative study of the Third and Fourth Republics indicates that proportional representation was used under the Fourth Republic and the outcome was not characterised by greater political stability. And when E.Faure sought an early dissolution in 1956 the pattern of votes did not show a great deal of change, though the allocation of seats did. However, it still left parliament evenly divided between three groups. The elections also revealed a great deal of disaffection with the regime as 2.5 million votes were cast for Poujadist candidates.[65]

Goguel (1946) adopted a binary taxonomy to analyse the French polity, under the Third Republic.[66] He divided the French political scene into two distinct groups that of "*ordre*" and "*mouvement.*" The *Bloc National* falls into the former category and the *Cartel* into the latter. However, his taxonomy though sufficient to explain the general tendencies within the French polity is not subtle enough to fully characterise the tendencies between and within parliamentary groups. It is important to realise that once elected party politicians formed distinct parliamentary groups of which there were significantly more than political parties. It is rather ironic that Goguel should make such a clear distinction between political tendencies when, in fact, during the inter-war years, the government would be determined by the behaviour of the radicals, who were with the "*parti de l'ordre*" when it came to

[64] see Levine (1925).

[65] see Siegfried (1956).

[66] see Goguel (1946).

individualism and finance,[67] but on social issues and republicanism they stood with the parties of "*mouvement*." This accounts for a great deal of the political instability of the inter-war years.

Thibaudet (1927) also delineated two tendencies within the French polity: the "*république radicale*" of provincials,- the republic of professors particularly, graduates from Ecole Normale, viz., Painlevé, Blum and Herriot,- ranged against this were economic interests, the press and Paris. Interestingly, given the post Second World War cultural history, much of the inter-war French intellectual scene lent to the right.[68] Thibaudet argued that France was characterised by a "*mystique de gauche*" to which all had to pay lip service. This is evidenced in the names attached to various parliamentary groups of the centre-right, representing the *Alliance-Démocratique*, which often carried the epithet "*gauche*." This was also the case in the Senate with the *Gauche Républicaine*. This, of course, reflected their attachment to the republic which in the early days of the republic had been one of the defining principles of the "left," in opposition to the assorted monarchists and bonapartists. Thibaudet explains much of the instability of the inter-war years in terms of the clash between these two tendencies.

However, Siegfried (1956) argued that one should actually distinguish between three tendencies: those outside the republic who had never reconciled themselves to 1789 and who, as Maurras did, greeted Vichy as a gift of providence;[69] the opportunists, a tendency which would later be represented by the *Alliance-Démocratique*; and the radicals. Siegfried's definition seems more complete and one should add the appearance of the Marxist parties, which at the end of the republic broke the stabilising gravitational pull of the centre.[70] This

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[67] Middleton (1932) has argued that this characteristic is accounted for by the support which the radicals found amongst peasant proprietors and shop-keepers,- the most socially conservative elements in society according to Lenin.

[68] see Thibaudet; and Halévy.

[69] see R.Rémond (1982); and Wilson in, Cairns (1978).

[70] Quoting Siegfried (1956): "*Depuis le 6 Février et le Front Populaire, la République, en tant que régime, est ébranlée. Le radicalisme, pilier traditionnel de l'édifice, est usé, débordé à gauche par des forces plus avancées, qui déplacent l'axe de la majorité républicaine. Une réaction naturelle entraîne dans ces conditions, les forces conservatrices vers une droite, non plus simplement conservatrice mais réactionnaire et vite factieuse, dont les espoirs dépassent bientôt le programme d'un simple redressement dans le cadre républicain. Pétain est devenu, dès 1934, l'espoir de cette réaction.*"p.80. This is perhaps a little too mechanistic an explanation for the rise of the Leagues, rather, it betokens an increasing disaffection with the political regime as well as the capitalist system.

is a fundamental tenet of Siegfried's thesis, viz., that when the right seemed to threaten the republican heritage (e.g., the *Bloc National*) this would produce a counter-swing to the left (i.e., the *Cartel*), however when this appeared to threaten financial interests a realignment to the right would occur (viz., Poincaré), Poincaré in turn being superseded by the *Bloc des Gauches*. However, it is Siegfried's thesis that this stabilising force was lost when the radicals lost something of their equilibrating role at the centre of the political spectrum as the Marxist parties became more prominent. The elections of 1936 marked a clear shift in that direction. However, one should qualify this as radical support remained crucial to the Popular Front coalition and when radical support shifted it was instrumental in a political realignment first to the centre and later the centre-right. However, that there was radicalisation of the polity is without doubt and this was equally the case to the right of the political spectrum with the increasing prominence of de la Rocque's *Parti Social Français* which might have won a hundred seats in the elections which were to have been held in 1940.[71] This somewhat obviates Hoffmann's contention that from 1934-44 France was a stalemate society.[72]

THE HISTORICAL COURSE OF THE INTER-WAR FRENCH POLITY:

In the first post-war elections the socialists refused to enter into an electoral alliance with bourgeois parties, such as the radicals. There was a feeling amongst the left, viz., the Marxist SFIO (*Section Française de l'Internationale Ouvrière*) and shortly the breakaway communists (*Section Française de l'Internationale Communiste*), of impending social upheaval and unwillingness to compromise. This expectation of change was derived from the international situation, particularly in Germany where the old regime had collapsed. The radical-socialists did not do well as they aligned themselves with *républicains du centre*.[73] The system of joint lists favoured the right, whilst the left was divided, the radicals could no longer enjoy the support of the left in the second round electoral run-off (*discipline républicaine*) which prevailed under the old electoral system. The vote had not changed

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[71] see Rémond (1982).

[72] Quoted in Kuisel, in Cairns (1978).

[73] see D.Halévy (1934) p.139.

much, rather it was the impact of the play of electoral alliances. The senatorial elections were conducted under the old system which salved radical influence.

The 1919-1924 legislature was characterised by preoccupation with realising a post-war political settlement and the need to deal with increasing domestic financial instability. This became particularly acute after the Ruhr invasion, which was launched at the very end of 1922. The new Chamber of Deputies faced a gathering exchange crisis which Poincaré had some success in reversing for a while, in March 1924, by means of currency intervention.[74] The exchange crisis had built-up due to the increasingly parlous state of the government finances, the failed Ruhr occupation and the feeling that the French franc might go the way of the mark. Poincaré's "bear squeeze" (currency intervention to force operators to cover short positions, i.e., buy the franc, pushing its value up through aggressive currency intervention) was accompanied by a proposal to raise taxes by 20% all round, the *double décime*. It failed to secure the approval of the radicals who objected to its regressive nature, particularly increases in indirect taxation. Elections were looming and the radicals did not want to be associated with it. They were also committed to abolishing the new turnover tax (*taxe sur le chiffre d'affaires*) which they considered regressive and a cause of the high cost of living.

The *double décime* as an across the board surcharge on existing tax rates represented an attempt to break the fiscal logjam. The socialists for their part also opposed the turnover tax, which had been introduced after the war by François-Marsal,[75] and proposed a tax on capital. The Poincaré government began to lose the support of the radicals over its fiscal proposals and Poincaré's bellicose foreign policy. Middleton (1932) argued that in 1924 the radicals and socialists were united against Poincaré's foreign policy.[76]

The radical ministers in the Poincaré government did not follow their party's condemnation of the government and resign. Nevertheless, Poincaré lost a vote in the Chamber and resigned (26/3/24),- though a recount indicated that he had retained a slender majority.[77] Poincaré formed a new government (29/3/24-1/6/24). He dropped the Finance

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[74] see chapter three of this thesis.

[75] Goguel (1946) p.194.

[76] Middleton (1932) p.155.

[77] Mayeur (1984) p.267.

Minister, de Lasteyrie, who had been responsible for the *double décime*, - his successor was François-Marsal.

The issue of the *double décime* was but the first of many fractious disputes surrounding the problem of increasing government revenue. In office the radicals shelved the projected abolition of the turnover tax. It had become a substantial source of government revenue.[78]

In the 1924 election the previous parliamentary majority was reversed and the *Cartel des Gauches*, an electoral pact between the radicals, independent socialists and socialists, secured a majority in the Chamber of Deputies and formed the government. This time the left had benefited by presenting joint lists, although not in all constituencies.[79] By 1924 the right and centre were no longer bound, as in 1919, by the twin objectives of enforcing the Versailles Treaty and anti-bolshevism. The Ruhr invasion had also alienated support. Poincaré's more tolerant attitude towards schooling the *proportionelle scolaire* (i.e., funding of schools on a proportional basis rather than allocating all funds to state secular schools)[80] helped alienate the radicals, as did his proposed cuts in administrative employment.[81]

It was the judgement of Tardieu and Halévy that an incestuous relationship had grown up between the public sector and the radicals. The public sector employees being the backbone of the secular state (particularly the teachers) and that in turn the radicals had become beholden to these "*ordre mendiants*" (mendicant orders).[82] This argument is consonant with the "Virginia" public choice school and the capture of government by organised interest groups. One should note that civil servants (and the army) could note vote,[83] which may well explain their active participation in political committees.

The cohesion of the *Bloc National* had fallen away and the radicals were returned as the largest party in parliament. The SFIO refused to participate in the *Cartel* government

[78] see chapter four of this thesis.

[79] Mayeur (1984) p.275.

[80] see Corcos (1927).

[81] see Halévy (1934).

[82] Quoting Tardieu (1936), *"Les ordres mendiants de la démocratie se liguent ainsi, avant chaque scrutin, contre l'intérêt public."* p.253.

[83] see Tardieu (1936).

headed by the radical-socialist leader Herriot, but agreed to support it. The *Cartel* had exploited the unpopularity of the *double décime* which aimed at raising 6bn. francs in new revenue and shelved it.

The radicals also abandoned the *bordereau de coupons*. This was a mandatory register of coupon payments which had to be held by banks on behalf of customers. The *bordereau* was introduced by the Poincaré government to try and arrest tax fraud. In its place the radical government introduced a *carnet de coupons* held by the individual. It was not mandatory and could be replaced by an assessment. This conformed with the precept of the fiscal reform of the revolution, the "*quatre vieilles*," which were based on non-inquisitorial assessments.[84] The radicals had to pander to their constituency of small-savers (see Herriot's statement to this effect in parliament) and it was hoped that abolishing the *bordereau* might help restore confidence. There was strong objection, throughout the spectrum of bourgeois political parties, to intrusive and inquisitorial forms of taxation.

The radicals and socialists were able to reach an electoral pact in the 1924 elections, in part, as a result of the split between the communists and socialists at the congress of Tours in 1920, which had seen the left break-away to form the Communist party. This made an electoral alliance the easier, as the left-wing of the former socialist party would probably not have sanctioned an alliance, with a bourgeois party such as the radicals. The communists refused to play the electoral game of the "*discipline républicaine*" and pursued a policy of "*classe contre classe*" until 1934. The communists labelled the socialists social-fascists, the meaning of which is rather obscure.

As we will see in chapter three, the *Cartel des Gauches* governments, which lasted from 1924-26, were characterised by a veritable rake's progress in public finances and concomitant inflation and exchange crises. Though, to be fair, they did inherit a precarious financial position, with a very large overhang of short-dated paper which needed to be re-financed. The debt overhang was not only due to war expenditure, but also to the costs of reconstruction,[85] and the way it was financed by issuing short-dated government paper.

During this period there were significant differences over measures to secure financial stability and resolve the fiscal crisis. One of the most signal mistakes, of Herriot's first

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[84] see Sauvy (1984).

[85] see chapter four of this thesis.

government, was not to adopt the recommendations of Pierre de Moüy's report, published on 27/6/24.[86] This recommended abandoning the deflationary François-Marsal Convention (which mandated an annual 2bn. franc reduction in outstanding Treasury borrowing from the Bank of France) and abolishing the "*double plafond*," the twin ceilings regulating the maximum issue of both Treasury bills and note circulation. De Moüy and Caillaux advocated a single ceiling (*plafond unique*) on the grounds that the government would have to relax one or other of the ceilings, particularly if they were to conform to the François-Marsal Convention. They argued that a single ceiling would prove a more flexible target and reveal the real monetary situation, viz., that short-dated Treasury bills and *bons de la Défense Nationale* were quasi-money, which if not renewed had to be monetised. In the event Herriot fell when it transpired that the ceiling on the note issue had been broken and that this had been disguised by means of creative accounting by the Bank of France.

During the period of *Cartel* government indecisiveness on the question of a capital levy increased uncertainty. The radicals were divided on the issue, but it was advocated by the socialists. The fact that the Herriot government enjoyed the support of the socialists, who favoured a 10% capital levy discouraged bond subscriptions and meant that the government could not attempt to consolidate short-dated paper.[87] Goguel suggested that Herriot's reliance on socialist support undermined his position and contributed to his fall before the Senate in April 1925.[88] He chose to fall on the issue of a capital levy to enhance his left-wing credentials. However, Goguel exonerated the Senate of the charge that it overthrew a government which still enjoyed a majority in the Chamber arguing that the Herriot government no longer enjoyed the true support of the Chamber.[89]

Herriot had been involved in rather dubious machinations on the question of the proposed capital levy which undermined his Finance Minister Etienne Clémentel. Clémentel opposed the capital levy and was led to believe that Herriot would instead request parliament to raise the ceiling on the note issue. However, Herriot contradicted him in Parliament and

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[86] de Moüy was head of the *Mouvement Général des Fonds*, which was responsible for the treasury operations involved in managing the public finances. It was late renamed the *Trésor*.

[87] see Goguel (1937).

[88] Goguel (1937) p.200.

[89] see Goguel (1937).

this left Clémentel with no option, but to resign on 3/4/25.[90] Clémentel was replaced by Anatole de Monzie. Herriot had the gall to argue that raising the ceiling on the note issue would be inflationary, given the previous recourse to unregularised borrowing (the "*faux-bilan*"), this was rather hypocritical. The socialists, who supported the *Cartel* but were not in government,[91] also favoured a steep income tax schedule, which undermined confidence.

It may well be that Herriot had decided to fall on the issue of a capital tax for symbolic reasons. Jeanneney (1977) has suggested that it was part opportunistic, as the government was bound to fall once the "*faux bilan*" became public knowledge. Caillaux, a radical affiliated to the *gauche démocratique*, led the opposition to the capital levy in the Senate. The Chamber of Deputies had supported the measure knowing that it would not get through the Senate.

This abandonment of parliamentary responsibility by the lower house recurred on two further occasions, in particular when the first Popular Front government fell on 2nd June 1937. In this instance Caillaux (the architect of the income tax legislation before the war) also led the senatorial opposition. The second instance occurred in April 1938 when Blum's short-lived second Popular Front government also fell in the Senate, when it requested decree-making powers in the financial field and introduction of exchange controls. His demand for decree-making financial powers had been supported in the Chamber, with reservations. Dubief (1976) argued that the radical deputies in the Chamber knew that it would not get through the upper Chamber.[92]

After the fall of the first Herriot government there was a period of instability which Goguel attributed to the lack of a parliamentary majority to implement a socialist policy, nor one which could bring a return to confidence with a policy finding support amongst moderates and radicals.[93]

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[90] see Jeanneney (1977).

[91] see Goguel (1946).

[92] Dubief (1976) p.216.

[93] Goguel (1946) remarked that during the period April 1925-July 1926, "*Il faut souligner l'importance que jouait dans cet enchaînement un facteur d'ordre purement politique: l'inexistence d'une majorité parlementaire. Au cours de ces seize mois, en effet, la Chambre ne put se décider ni en faveur d'une politique conforme au programme socialiste, qu'auraient appliquée les groupes du Cartel, ni pour les mesures propres à rassurer les capitalistes, qui auraient exigé, par la coalition des modérés et des radicaux, la formation d'une nouvelle majorité.*" p.201. Mayeur's analysis (1984) of this period conforms with Goguel's, "*S'ouvre alors d'avril 1925*

Middleton (1932) argued that this period saw a significant increase in the influence of the finance committee of the Chamber of Deputies.[94] Its composition reflected the 1924 electoral outcome and had a radical President and *rapporteur*. This led to occasional clashes with government as its composition did not reflect the shift in majority in parliament towards the moderates. These clashes abated when Poincaré became Prime Minister in 1926.

The Herriot government was succeeded by two radical governments headed by Paul Painlevé. His first government (17/4/-27/10/25) saw Joseph Caillaux at the Finance Ministry. Caillaux issued an exchange guarantee loan which aimed at consolidating the floating debt. Caillaux also secured a 6bn. franc advance from the Bank of France. The exchange guarantee loan, a measure of the loss of confidence, was not a great success. A forced conversion loan (*emprunt forcé*) had been mooted, but rejected.[95] Painlevé resigned following the radical congress held in Nice (27/10/25) at which Herriot and Caillaux had clashed, and Caillaux's financial policy was criticised.[96]

Painlevé's second government did not include Caillaux in order to retain radical support. Painlevé took the finance ministry and Georges Bonnet the ministry for the budget. Bonnet resurrected de Monzie's proposed capital levy. However, the government fell on 22/11/25.[97] There followed three successive Briand governments none of which managed to resolve the financial crisis. In Aristide Briand's third government (of the 1924 parliament), Caillaux was vice-president of the council (deputy Prime Minister) and Finance Minister. However, Caillaux's attempt to secure decree-making financial powers to implement the recommendations of the Sergent committee report failed. The Sergent committee would later be the blueprint for Poincaré's stabilisation measures in 1926.

The opposition was led by Herriot, who left the speaker chair's to launch an attack on Caillaux and the grant of decree-making powers which ran counter to parliamentary

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à juillet 1926, une période d'instabilité, dont, par-delà les péripéties, il suffit de marquer la signification. Faute de trouver la confiance des milieux financiers, aucun des six gouvernements qui se succèdent ne résout la crise. Les divisions au sein même des radicaux, fondent l'instabilité. La concentration avec les modérés, voeu des radicaux du Sénat et d'une parti des radicaux de la Chambre, trouve l'opposition des radicaux Cartellistes."

[94] Middleton (1932) p.165.

[95] see Goguel (1937).

[96] see Bonnefous (1960) vol.4.

[97] Mayeur (1984) pp.282-283.

responsibility. Herriot's plea was made in defence of parliament against a strengthened executive.[98]

One may well wonder whether Herriot's behaviour was not part-dictated by personal vindictiveness against Caillaux for bringing down his own government. The right was reluctant to lend its support to Caillaux, given his impeachment for supposed collaboration with the enemy during the war. Caillaux had been pardoned by the *Cartel*. This had opened the way for his return to political life. The feud between Herriot and Caillaux, both radicals, is illustrative of the difficulties of building a cohesive majority with such a heterogeneous party. Herriot, responsible for the fall of the government, was asked to form a ministry. It lasted one day (20/7-21/7/26). This opened the way for a mid-term concentration around the centre, which would become a characteristic of the following parliaments.

The man chosen to form the next government was former President Raymond Poincaré, who as a senator could claim a certain remoteness from the party political fray.[99] Poincaré could rally the left with his commitment to the secular republican state and the right by means of his nationalism and robust foreign policy.[100] Poincaré headed an ecumenical coalition. A government of *Union Nationale* which brought together representatives of all parties, bar the Marxists, viz., the SFIO and the communists. Amongst thirteen government ministers six were former prime ministers.[101] Despite radical participation the government was firmly to the centre-right. Poincaré as president of the council of ministers from 1926-29, (he had been president of the Republic from 1913-20), restored confidence and secured a package of measures which consolidated and balanced the budget.[102] His was the first government, of many, which secured decree-making powers in the financial and budgetary field in order to restore financial stability. This broke the fiscal impasse, which had lasted from the debate over the *double décime* to the formation of the Poincaré government in 1926.

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[98] see Jeanneney (1977).

[99] Middleton (1932) argued that the prominence of non-party leaders such as Briand, Poincaré, Barthou and later Tardieu and Laval could be ascribed to the need for the head of government to act as broker between factions and parties represented in coalition governments.

[100] see Thibaudet.

[101] see Mayeur (1984).

[102] The *président du conseil (des ministres)* was in effect Prime Minister, throughout this thesis these two expressions will be taken to be coterminous.

During this period Poincaré headed two governments. In the first (23/7/26-6/11/28) he took the Finance Ministry. His second was formed after the radical congress at Angers (4/11/28) at which Caillaux, in a late night session from which Herriot was absent, was able to push through a motion condemning the policies of the government. This forced Herriot's resignation from the government. This was Caillaux's revenge for Herriot's similar action at the congress of Nice in 1925.[103] The radical-socialists did not participate in Poincaré's second government as they had laid down as preconditions implementation of their programme endorsed at Angers and the exclusion from the government of the *Union Républicaine Démocratique*. The group *Union Républicaine Démocratique* was also known as the "*Groupe Marin*."[104] Many deputies of the *Fédération Républicaine* sat within this group in the Chamber. Poincaré could not accept these conditions. However, to avoid alienating the radicals he excluded L.Marin (leader of the right of centre *Fédération Républicaine*) who had attacked the coup of Angers at a meeting of the *Union Républicaine Démocratique*. Without the radicals Poincaré's last government could no longer claim to be one of *Union Nationale*.[105]

The experiment with an ecumenical government of *Union Nationale* was repeated with less success under Doumergue in 1934.

The demise of the *Cartel* was also to reveal a recurring characteristic of the various legislatures during our period of study. The inter-war parliaments of: 1924, 1932, and 1936, which ushered in victories for the centre-left and/or left witnessed, in mid-term, a shift from coalitions, originally based on a broad alliance of the left, to governments which found their support towards the centre and even centre-right. Part of the problem was due to the inability to construct a cohesive programme of government from within such disparate interest groups, as the radicals and socialists and later from amongst radical-socialists, socialists and communists as in the Popular Front. As Siegfried (1956) argued, although the political regime had to pay lip service to the ascendant progressive ideology (*de gauche*) in practice it could only be governed from the centre. The fact that the Chamber was returned with majorities of the left (excepting 1919 and 1928) lent it instability. A solid majority of

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[103] see Bonnefous (1960) vol.4.

[104] see Bourgin (1928).

[105] Bonnefous (1960) vol.4, p.292.

the right was excluded because of the split within the right and the reluctance of the radicals to compromise their left-wing credentials, for too long, by dealing with a party such as the *Fédération Républicaine* which did not subscribe to the dogma of the secular state.[106]

In 1926, 1934 and 1938 we see governments of the centre-left being superseded by governments of the centre, with the radicals playing a crucial role in this shift.[107] As we have seen Siegfried (1956) argued that this balancing movement was due to the gravitational pull of the centrist radicals.

THE RADICALS AND FRENCH POLITICS:

The radicals found their support amongst rural small-holders and the professions. They were in a sense a "*petit-bourgeois*" party. This made co-existence with the left sometimes difficult and an enduring agreement on a coherent economic programme hard to achieve. In the post-1918 period the radicals found themselves near the centre of the political spectrum as a result of the appearance of new parties to their left, namely the socialists and then the communists. In a sense their place in the political spectrum was akin to that sometimes occupied by liberal parties in contemporary western Europe. Their position in the middle of the political spectrum and the lack of a cohesive bloc on the right, as well as the split within the left caused by the refusal of the communists to co-operate with other parties of the left until 1934, meant that the stance of the *gauche radicale* and the radical and radical-socialist party was central to any governing coalition or political re-alignment. Even after the elections of 1936, which returned the socialists as the largest party in the Chamber of Deputies, the left

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[106] Quoting Siegfried (1956), "*Le régime, en effet, dans son idéologie, ne peut que tendre à gauche, mais il ne peut s'organiser et vivre que par le Centre, non par la Droite, dont nous avons souligné qu'elle est réactionnaire, non pas conservatrice. Il faut donc, avec une majorité de gauche, faire une politique de centre, plus exactement une politique économique de centre, éventuellement contredite par des déclarations de principe de nature à satisfaire ou à apaiser les militants.*" p.46.

[107] Quoting Olé-Laprunne (1962), "*La formation des "ministères d'union" annonce toujours le second "versant" d'une législature inaugurée par la victoire électorale des forces de gauche Poincaré en 1926, Doumergue en 1934 et, dans une certaine mesure Daladier en 1938, symbolisent la désagrégation progressive des formules de gauche. Avec une sagesse tardive, les valoisiens renoncent à "radicaliser" les socialistes et cautionnent - sous l'étiquette de gouvernement d'union - une expérience plus modérée.*" p.186. The reference to the "*valoisiens*" is to the radical and radical socialist party headquarters in the *rue de valois* in Paris.

could not govern without radical support.[108]

The slightly schizophrenic attitude of the radicals is part explained by the radicals' historical attachment to the values espoused by the left, viz., lay schooling, division of church and state,[109] acceptance of the revolutionary mythology, and a suspicion of large capital captured in Edouard Daladier's tirade against the so-called 200 families. His attack against the 200 families was first made at the radical party congress held at Nantes on 28/10/34.[110] The reference was to the 200 largest share-holders of the Bank of France who elected its governing board, the *conseil de régence*.

Cynicism was not absent from the political behaviour of the radical-socialists who withdrew their support from the Poincaré government (15/1/22-26/3/24), to benefit from a political realignment to the left, and again in 1935 from Pierre Laval's (7/6/35-22/1/36) increasingly unpopular government. In the latter case opposition within the radical-socialist party to Laval's conciliatory policy towards Italy, over Abyssinia, afforded them the ideal opportunity to extricate themselves from a government in which they had fully participated.

The *conseil de régence* of the Bank figured high in the demonology of the left, particularly its supposed role in undermining the *Cartel* governments of 1924-26. As Jeanneney has demonstrated this was not true. However, the myth was what counted. The *conseil* had been divided in 1925 over whether to publish the true level of outstanding Bank of France notes which had exceeded their ceiling (*plafond*), fixed by parliament. Edouard de Rothschild and Horace Finaly,[111] were willing to give the Herriot government time to regularise the situation. This did not happen and François de Wendel, a senator for the *Fédération Républicaine* threatened to resign if the real balance sheet of the Bank were not published. This forced the issue into the open. However, de Wendel merely acted as a catalyst as the real situation was already becoming known,[112] through evidence submitted

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[108] Quoting Olé-Laprunne (1962), "*La souplesse et la variété de ses positions ont valu au parti radical-socialiste sa vocation gouvernementale. Qu'il délègue ses chefs, qu'il délègue des personnalités de second plan, qu'il participe indirectemment au pouvoir par l'entremise des sénateurs, le parti valoisiens a presque constamment assumé les responsabilités gouvernementales.*" p.204.

[109] see Lefranc (1973).

[110] Lefranc (1974) pp.79-80, footnote 3.

[111] see Jeanneney (1976).

[112] see Jeanneney (1976).

before a parliamentary committee.

The radicals though supporting the lay state and harbouring doubts about the merits of an unfettered economic liberalism, still retained a strong belief in individualism, whilst the new parties of the left had a Marxist class-based approach. The radicals were opposed to monopoly capitalism, e.g., trusts and cartels. In a word the radicals represented, "*les petits*". Within the radical party there remained a strong Jacobin tradition of patriotic nationalism which meant that they were at odds with the more pacific internationalist tendencies within the Marxist parties. The *Républicains-Socialistes*, also followed the Jacobin tradition.

Difficulties of political co-habitation would be apparent in the Popular Front. The SFIO (the socialist party) and its leader Léon Blum, looked on devaluation and exchange controls favourably as possible policy options, as well as the introduction of a capital levy. However, these had to be abandoned in order to secure the electoral support of the radicals. One should also note that the communists were virulent opponents of devaluation.[113]

In fact it was amongst the radicals and affiliated radical groups that one could find some of the foremost, and most influential exponents of financial orthodoxy, men such Caillaux who in his capacity as head of the Senate Finance Committee from 1932 was extremely powerful and was instrumental in the fall of the first Herriot and Blum governments in 1925 and 1937 respectively. Louis Germain-Martin (*gauche radicale*), deputy and Finance Minister in Edouard Herriot's 1932 government (3/6-14/12/32), in Gaston Doumergue's government (9/1-8/11/34) of *Union Nationale*, and Flandin's government (8/1134-31/5/35), was no less influential a figure amongst the radicals particularly as he was also a professor at the prestigious *Ecole Libre des Sciences Politiques* (*Sciences-Pô.*). By means of his newspaper articles he was able to find a suitable platform from which to make the case for financial orthodoxy.[114] As one commentator quipped, the radicals had their hearts to the left, but their pocket-books firmly to the right.

The radicals were dominant in the Senate where their group was known as the *gauche démocratique*. The Senate radicals were particularly orthodox on financial matters.[115]

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[113] see chapter seven of this thesis.

[114] see chapter seven of this thesis.

[115] see Goguel (1937).

Middleton (1932) attributed the radicals' financial conservatism to their petty bourgeois constituency of peasant proprietors and shop-keepers.[116]

Another cause of instability was the unwillingness of the socialists to participate in government under the *Cartel*. They were only willing to offer their parliamentary support. This made it more likely that they would eventually withdraw their support than if they had participated in government and policy-making. An instance in which the socialists undermined a radical government was their failure to support Camille Chautemps' request for decree-making powers in March 1938. The communists had earlier withdrawn their support when accused by Chautemps of backing the strike-wave of that year.[117] The radicals were no less unstable political allies withdrawing their support from Doumergue's 1934 government following his request for three budgetary provisional twelfths. This would have prorogued the existing budget for a further three months. Tardieu argued that the request was dictated by the possibility which such a facility would afford to dissolve parliament and hold fresh elections. Herriot who had been in the government felt that it would give Doumergue too much autonomy, as a result the government fell on 8 November 1934.

The radicals were also opposed to Doumergue's proposed constitutional reforms which would have enhanced the power of the executive. The radical party which benefited from the parliamentary regime, as the essential ingredient of any coalition, understandably did not want to see the power of parliament eroded. This was the second time, in a little under three years, that the radicals had blocked reform by bringing down a government (the first being Laval's government).

The radicals also withdrew from Laval's deflationary government in 1935 when it became apparent that its unpopularity would lead to defeat at the polls. They joined what became the *Rassemblement Populaire*, later dubbed the *Front Populaire*.

In the case of the *Cartel* governments as well as the Popular Front governments the need to preserve a sense of ideological purity prevented participation by the socialists and the communists respectively. Though in the case of the first Popular Front government, the leader of the communist party, Maurice Thorez, was not opposed to participation. It appears

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[116] Middleton (1932).

[117] see Dubief (1976).

that the decision came from the central committee. According to Bonnefous the central committee did not want to play into the hands of their political opponents who would point to communist participation in government to undermine confidence.[118] The communists refused to participate in government, with the exception of Blum's failed 1938 attempt to constitute a government from the communists to the *Fédération Républicaine*.

Possibilities for strong broad coalitions of the right were undermined by the fragmented nature of the relevant parties and parliamentary groups and the anti-republicanism of the far-right.[119] For the radicals participation in any such permanent re-alignment posed problems on two counts. Any successful coalition of the centre-right required the participation of the radical-socialists and/or radicals. This would mean that the radicals would have to break ranks with the parties which claimed as theirs the republican heritage. Such a broad coalition would have foundered on the question of laicism, which remained an important part of the collective imagery and tradition of the radicals. This would be particularly so in the case of an alliance with the *Fédération Républicaine*, headed by Louis Marin. Though the *Fédération* accepted the revolution it did not share the same belief in the lay state as an essential constituent building bloc of the republic, as did the radicals. It is no coincidence that de Wendel who was from Lorraine and catholic was a member of the *Fédération Républicaine*. Marin and de Wendel both represented an eastern department: the Meurthe-et-Moselle. De Wendel was also the owner of Le Temps, the forerunner of Le Monde, he headed the steelmakers association the *Comité des Forges*, and was a prominent regent of the Bank of France.[120]

On a more practical level, the radicals had to avoid making irreconcilable enemies on their left, as they relied on electoral support and alliance with these parties. This was particularly so under the old electoral system, re-introduced in 1927 for the 1928 general election. The leitmotif of the radicals was Camille Pelletan's cry, "no enemies to the left."[121] This was to ensure that republican discipline, viz., encouraging voters to support

[118] see Bonnefous (1965) vol.3.

[119] Middleton (1932) argued that "purposeful" coalitions were more likely to the left of the political spectrum as, ... "a bloc national majority always has an unreliable left wing composed of Moderates who are afraid of being confounded with the doubtful Republicans of the extreme Right." p.156.

[120] see Jeanneney (1976).

[121] Middleton (1932) p.74.

the best placed left candidate in the second round, would work to their advantage. This happened in 1932, but in the 1936 elections with the communists now bowing to republican discipline and the polarisation between blocs the radicals lost many seats and were superseded as the largest party in parliament by the socialists. Mayeur (1984) states that the radicals had expected to be the largest party.[122]

THE NEW ELECTORAL SYSTEM AND DOMESTIC POLITICS:

The resurrected electoral system was based on local constituencies with a second ballot when no candidate obtained an absolute majority in the first round. The return to this electoral system was in part a result of the arguments of radicals Camille Chautemps and Albert Sarraut that it would tend to disfavour the communists, who at the time refused to play the electoral game and enter into expedient electoral alliances. Bonnefous (1960) states that, in 1928, Moscow had instructed the communists not to collaborate in electoral strategies with parties of the left. Mayeur attributed the dominance of moderates from the Congress of Tours to the *Front Populaire* to the failure of the communists to play the *discipline républicaine*.[123] The radicals thought that a return to the old electoral system would be to their advantage as it would allow tactical alliances to play in their favour in the second round of voting.

Communist failure to follow republican discipline split the vote of the left (that of the socialists and communists). Blum, leader of the SFIO had not opposed the reform, as long as the alternative was a form of adulterated proportional representation. There was a two week period between ballots. This allowed inter-party bargaining for support in the second round. In order to attenuate this, and as a token reform, this period was eventually reduced to one week.

The 1928 elections were a victory for Poincaré who used the authority of his electoral mandate to restore the gold convertibility of the franc on 25th June 1928 (the so-called

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[122] see Mayeur (1984).

[123] Quoting Mayeur (1984, p.323), *"Jusqu'à l'été 1934, les positions et la stratégie du PC interdisent l'unité à gauche, et le jeu classique de l'affrontement des deux blocs. Sans doute faut-il voir là, comme dans la peur suscitée par le bolchevisme, l'une des raisons du primat de fait des modérés pendant cette période qui va du Congrès de Tours au Front Populaire."*

Poincaré franc). In the 1928 election the radicals did not enter an electoral alliance with the socialists. Though the radicals participated in Poincaré's government of *Union Nationale* the radical congress of 1927 had rejected an electoral alliance with the parties of the right. As Bonnefous (1960) pointed out this led to the paradox of the radicals being in government with parties of the centre-right, whilst leaving open the possibility of a tacit electoral alliance with the socialists in the second round of elections.[124] However, in the election campaign most radical candidates were keen to identify themselves with the policies which had been pursued by Poincaré's government of National Union.

Bonnefous (1960) argued that under the previous proportional electoral list system the radicals would not have done as well. This would have forced them to adopt a more clearly defined position. The new constituency based system favoured individuals rather than ideas. The radicals could benefit from having participated in the outgoing government, whilst picking-up socialist votes in the second round. Bonnefous pointed out that the communists lost seats because of their uncooperative electoral tactics.

The endorsement which Poincaré's policies received at the polls was part personal and his parliamentary majority was heterogeneous. He retired for health reasons on July 27th 1929. With his departure there was a succession of centre-right governments. Though the radicals withdrew support from the centre-right Tardieu and Flandin governments they themselves were unable to form lasting governments and secure socialist support.

Daladier, a radical-socialist, tried to form a government following Poincaré's resignation. However, the SFIO refused to participate, despite willingness on the part of the parliamentary party. This paved the way for Tardieu to form a centre-right government in 1929. It lasted from November 1929 to February. André Tardieu's economic programme aimed at creating economic prosperity through a policy of public works. However, the onset of depression precluded this as the Chéron budgetary surpluses (*"Trésor Chéron"*) soon turned to deficit. Tardieu lost radical support and fell in Spring 1930. Bonnefous (1960) argued that the Chamber and the Senate were more to the left than the government. Chautemps, also a radical, failed to form a government with the socialists and this opened

[124] Quoting Bonnefous (1960), *"Le Congrès radical de 1927, soucieux de conserver la clientèle électorale du parti et désireux que les candidats radicaux ne passent point pour réactionnaires, avait rejeté tout accord électoral avec les partis de droite. Ainsi les radicaux, appartenant à la majorité gouvernementale, ne seraient susceptibles d'alliance électorale qu'avec l'opposition socialiste! Ils se réclamèrent cependant presque partout de la politique d'Union nationale."*

the way for Laval (January 1931-February 1932).

Laval fell in the Senate on the issue of electoral reform. He had proposed a single ballot in constituency elections, unless any candidate failed to obtain 25% of the votes cast. This was intended to promote the formation of pre-electoral blocs, forcing smaller parties to concentrate. Getting rid of the second round would have eliminated the power which parties could exercise by trading their support between electoral rounds.[125]

Goguel argued that having a second round run-off in the French electoral system encouraged small parties which would bargain away their electoral support in the second round. Subsequently constraining the autonomy of political parties. However, the British system today which has many short-falls, owes part of its stability to the highly concentrated geographical support which both major parties enjoy, as well as the winner takes all single member constituencies. In the contemporary British case were the Liberal-Democrats to enjoy a similar geographical concentration of support as the two larger parties, the first-past-the-post system would produce a three party system.

However, any analysis of the French inter-war polity makes it clear that the lack of cohesive electoral blocs or parties and the size and singularity of the radicals and radical-socialist party made the prospect of any lasting coalition tenuous. The parties of the centre and right also lacked coherence and for historical reasons, specific to the political culture of the radicals, a broad coalition of the centre-right would tend to be unstable, as the radicals, though orthodox on financial issues, identified with the "republican tradition" of the left. This was of crucial significance in the period to 1936 in preventing a crystallisation of the political system into two clearly defined blocs. Though the radicals did participate in moderate and centre-right governing coalitions these alliances proved tenuous. The radicals were hesitant about any fundamental shift into coalition with the right as it might compromise electoral alliances with the socialists and particularly in the second round run-off in the electoral system re-introduced in 1927.[126] Refusal by the communists to play the republican electoral discipline (*discipline républicaine*) precluded the formation of a solid left bloc.

Shirer (1969) was of the view that, "Part of the cause of the instability of French

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[125] see Bonnefous (1960).

[126] see Mayeur (1984).

governments under the Third Republic was the weakness of the political party system. In all its time no single party ever had a majority in Parliament or came close to having one. Each government had to depend for its life on the support of at least two or usually half a dozen parties, with their conflicting interests and aims."[127]

As we have seen both proportional representation and single member constituencies were experimented with. This demonstrates that the problem of political instability was more deeply rooted and was conditioned by the cultural and historical heritage.

However, as Olé-Laprunne (1962) has clearly demonstrated, the usual superficial analysis of the French political system fails to make the essential point that, paradoxically, the greater governmental instability, the less the political figures and scenery change.[128] Ministries, from one government to another, might well remain in the same few hands. This seeming paradox points to the real nature of the problem which was the inability of the French political establishment to address the underlying economic issues, or to renew itself in an alternative coalition of interests able to tackle the recurrent fiscal crisis of the state.[129]

In order to underline the instability which followed Poincaré's retirement Bonnefous (1960) pointed out that in the period 1922-29 Poincaré was twice prime minister for a total of five and-a-half years, whilst between 1930-36 there were 18 governments in six and-a-half years. In these circumstances Bonnefous argued that it was impossible to conduct a proper economic policy. Olé-Laprunne attributed the difficulties of this period to the inability of an individual to assert himself and also enjoy parliamentary support.[130]

Looking back over the period, with the benefit of hindsight, we can trace some of the political failings, which seem to lead with a certain inevitability to surrender of all political

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[127] Shirer (1969) p.77.

[128] see Olé-Laprunne (1962).

[129] Quoting Olé-Laprunne (1962), "*Incontestablement, le développement du remaniement constitue, en fin de régime, un élément spécifique, permanent qui n'existait qu'exceptionellement entre 1880 et 1910. Nous assistons alors à un véritable blocage du système: le retour des personnalités appartenant au Cabinet démissionaire dans le nouveau ministère traduit un réflexe d'impuissance plutôt qu'un souci de continuité. Au début de la III République, le remaniement se justifiait par la faible gravité des crises. Après 1920, il est la conséquence de l'impossibilité politique de résoudre une crise permanente.*" p.231. He defines a "*remaniement*" as a cabinet in which some 50% of outgoing ministers are present in the next government. p.228.

[130] Quoting Olé-Laprunne (1962), "*Aucun leader n'est parvenu à s'imposer au cours des années 1934, 1935, 1936. Nous devinons dans les constants appels du chef de l'Etat aux présidents des assemblées, le souci de dégager une personnalité suceptible de s'imposer au Parlement.*" p.189.

power to a legally "absolute" executive under Marshal Pétain and military defeat. We can discern a similar pattern under the Fourth Republic, the sudden growth of a disaffected extra parliamentary movement, the Poujadists, protracted ministerial and foreign policy crises, followed by a final domestic and foreign policy emergency paving the way for a strong man, in both cases with a military background, known to harbour contempt for parliament and parliamentary parties and their machinations, viz., General de Gaulle.

THE 1932 ELECTIONS, THE LEAGUES, AND CRISIS OF THE RADICAL STATE:

The 1932 elections saw a victory for the *Bloc des Gauches*. This was a personal defeat for the outgoing prime minister, Tardieu, who had been involved in the electoral campaign. The involvement of the prime minister was considered an exception to recent tradition[131] and, as such, the election was a blow for him.[132] The victory of the left was partly a result of discontent with the worsening economic situation, which was beginning to affect France, and Laval's deflationary policies in the period January 1931 to February 1932. However, the right did not do as badly as it might have, as communist failure to follow republican discipline split the left vote.[133]

The new parliament witnessed renewed budgetary crises and recourse to Bank of France borrowings in order to finance the budget deficit. The second Herriot government, which lasted from June to December 1932, failed to resolve the crisis. According to Mayeur (1984) Herriot's government which was almost entirely radical did not enjoy the support of the moderates, which it needed to pursue its financial policies. These policies with Germain-Martin (*gauche radicale*) at the finance ministry included reductions in expenditure and tax increases.

The socialists were hostile to these measures and the radicals were divided as elements within the radical party did not want to disassociate themselves from the socialists. Herriot was unable to construct a solid centre coalition to support his policy, as the Senate would

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[131] see Bonnefous (1960).

[132] Mayeur (1984) p.326.

[133] see Bonnefous (1960).

have favoured.[134] Herriot chose to fall before the Senate on the question of ratification of the French war debts to the US.[135] Following the unilateral Hoover moratorium, which effectively excused Germany from honouring her debts to France, the French Senate was in no mood to continue war debt payments. Goguel (1946) argued that Germain-Martin's policies proved too orthodox for the Chamber majority which was composed of parties of "*mouvement*" who could not accept it.

The Herriot government was succeeded by a series of radical governments of a more centrist persuasion, often characterised by a return of the same people to office leaving the fundamental financial and economic problems unresolved.[136] Herriot's and subsequent radical governments pursued orthodox deflationary policies. It is often asserted that Herriot's traumatic experience of financial crises during his first term was the reason he stuck to the most orthodox of policies with Germain-Martin as his Finance Minister. Germain-Martin later reflected that the instability which characterised this period was due to the inability of radical governments to get parliament to approve various deflationary packages.

This increasing paralysis of the executive was mirrored in the progressive rise of the extra-parliamentary right-wing Leagues, particularly Colonel (*Comte de*) de la Rocque's *Croix de Feu*, which favoured strong government and rooting out corruption. There were some Leagues which were closer to fascism and harboured more anti-parliamentary sentiments, such as Pierre Taittinger's *Jeunesses Patriotes*, though Petitfils (1983) argues that they were not fascist but an authoritarian and nationalist movement. The league which appears to have been closest to fascism during the inter-war years was Georges Valois' *Faisceau*, but it fell apart in the late 1920s.

The Stavisky financial scandal of 1934, involving the use of forged bonds as loan collateral, his ability to avoid going to trial on a series of existing charges, the circumstances

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[134] Mayeur (1984), "*L'attitude des modérés ne permet pas à Herriot de réussir une concentration qui aurait la sympathie de la majorité du sénat.*"

[135] Mayeur (1984) pp.328-329.

[136] Quoting Olé-Laprunne (1962), "*Les crises sont des moments de fausse activité dans un monde politique immobile. Ce n'est pas un des moindres paradoxes de la III République que d'avoir métamorphosé la crise en élément de conservation. Elle pose des problèmes - souvent mineurs - et ne les résout pas. Ainsi s'expliquent les chutes successives des ministères butant sur le même obstacle.*" p.297. And Olé-Laprunne would add, "*Parallèlement à la crise, la stabilité des ministres se présente comme une donnée permanente de la vie politique française.*"

of his suicide and rumours of involvement in high places particularly by radical politicians contributed to a disenchantment with the political class. The political establishment was sometimes characterised as drawn from the provinces, often south of the Loire [137],- Herriot was Mayor of Lyons. The scandal forced the resignation of the Chautemps government. He was succeeded by another radical, Daladier. However, the heated political situation sparked riots and a march on the Chamber of Deputies on the 6th of February 1934.[138] The main participants in these riots were the right-wing Leagues and in particular de la Rocque's *Croix de Feu*, though there was communist participation. The riots brought down the Daladier government. The deaths which resulted from the police firing into the crowd to prevent the demonstrators from crossing the Seine and investing the Chamber of Deputies earned Daladier the epithet, from the right, of "*fusilleur.*"

Mayeur (1984) suggested that the Leagues and the riots helped save the parliamentary regime by breaking the political logjam.[139] In the contemporary international context the crisis united the left and was instrumental, along with Moscow's decision to allow the communist party to collaborate with the parliamentary parties of the left, in bringing together the *Rassemblement Populaire*, or, Popular Front as it became known. Crucial to communist participation and radical willingness to consider such a coalition was the change of tack by the communists on defense. This was precipitated by the Franco-Soviet non-aggression pact of 2/5/35 paradoxically negotiated by Laval as Foreign Minister in Flandin's government.[140]

Gaston Doumergue (President from 1924-31), and no longer even a parliamentarian, was called-out of retirement (his reclusive retirement had earned him the epithet "*l'ermite de Tournefeuille*") to stabilise the political situation. He formed a government of *Union Nationale*, though in practice the government was aligned around the centre-right. His government included two deputy-prime ministers, Herriot and Tardieu. They represented the two alternative government coalitions.

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[137] see Middleton (1932). It is also interesting to note that in Italy today the Leagues derive some of their electoral support from the feeling that the political scene is dominated by incompetent and clientelist southern politicians.

[138] see Shirer (1969) who offers a vivid eye-witness account as seen from the *Hotel de Crillon!*

[139] Mayeur (1984) p.333.

[140] see Bonnefous (1965).

Doumergue fell when the radicals abandoned the government. This followed Doumergue's request for three provisional budgetary twelfths. The radicals objected to this on the grounds that it would give Doumergue too much autonomy from Parliament and thereby reduce the radical party's leverage over the coalition. Doumergue resigned on 8th November 1934 and returned into retirement.

Herriot's withdrawal was due to his unwillingness to lend legitimacy to what was in practice a centre-right government. Doumergue's use of radio addresses alienated the radicals who felt that it was used as a means of by-passing parliament. Doumergue was closer to Tardieu also a strong advocate of parliamentary reform. Rémond (1982) argued that Tardieu had inspired Doumergue's reform proposals.[141] Though Doumergue was granted decree-making powers, he failed to capitalise on the momentum generated by the riots and his suggestions on constitutional reform gradually lost their attraction as the sense of urgency abated.[142] The failure of Doumergue's government to make any headway towards realising constitutional reform proved a climacteric for Tardieu, who had been a Minister of State in the government. He now abandoned any hope that reform could be realised from within the existing political system.[143]

CONSTITUTIONAL REFORM PROPOSALS:

The reform proposals, recommended by the commission Doumergue appointed, were along the lines of those suggested by President Alexandre Millerand (1920-1924). Millerand's experience is instructive, as it marked a further step in weakening the presidency, which had been dealt a fatal blow in 1877 when Mac-Mahon's dissolution of the Chamber and subsequent elections failed to return the majority he sought. The weak presidency and the increased authority of a fractious parliament are important to understand the nature of the

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[141] Tardieu published a book entitled L'heure de la décision (1934) as Doumergue's government came to office, it advocated constitutional reform.

[142] see Dubief (1976).

[143] Quoting Tardieu Le souverain captif (1936), *"La chute du cabinet (Doumergue) et les conditions de cette chute ont prouvé que j'avais eu tort d'espérer et que l'unanimité des partis était faite contre toute réforme de nature à troubler les habitudes et commodités des élus."* (p.17). And in the forward to this book Tardieu confessed, *"J'ai cessé de croire à la possibilité, soit pour la France de tolérer, soit pour les Chambres de corriger le régime sous lequel vit la France."* (p.8); see also, Tardieu, Alerte aux Français (1936).

French inter-war polity,- Siegfried (1956) argues that it is crucial. One should also note the increased authority of the Senate. In the circumstances the presidency was not able to break the institutional deadlock.

Millerand had been forced from office by the incoming *Cartel* government of 1924, because of his apparent involvement in the electoral campaign. Particularly his October 1923 Evreux speech in which he spoke-out in favour of granting the President more power, affirmed his right to dissolve the assembly, and appeared to support a programme closer to that advocated by the right.[144] In fact Millerand's speech could only be interpreted as a full scale attack on the left. The President argued in support of free schools, viz., no discrimination between lay and denominational schools; he condemned the war against the congregations; applauded the recently renewed diplomatic ties with the Vatican; praised Poincaré's firm foreign policy; indicted Russia and the communists, arguing that this experience illustrated the need for private property; and commended a conciliatory social policy rather than one which encouraged class conflict and pitted Frenchman against Frenchman.[145] The result was that the *Cartel* majority refused to form a government. Millerand asked the outgoing Finance Minister F.François-Marsal, a personal friend, to form a government. It lasted one day. Millerand, who could hardly dissolve parliament immediately after a general election, was forced to resign.[146] However, the Cartel's presidential candidate, Paul Painlevé failed to secure election and Doumergue was elected President instead. Doumergue later supported the new governmental majority that emerged under Poincaré in 1926. Millerand's experience ensured that presidents would be more circumspect from then-on.

Millerand went-on to form: *La Ligue Républicaine Nationale* (also known as the: "*Ligue Millerand*"), to oppose the *Cartel des Gauches*.[147] It was thought that a disciplined opposition was needed to combat parties of the left which tended towards organisation because of their strong collective ethos. What was particularly galling to the left was that Millerand had been a socialist! The "*Ligue*" proposed to increase executive authority and

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[144] see Middleton (1932).

[145] see Millerand (1923).

[146] see Jeanneney (1977).

[147] see Bourgin (1928).

re-establish the divisions of power between branches of government, particularly to detach the executive from parliament. Millerand wanted to reinforce the authority of the President and facilitate the dissolution of the Chamber of Deputies by abrogating the need to obtain the consent of the Senate. Millerand's successor as head of the Ligue was, André Maginot. Amongst political figures who participated in its activities were: Frédéric François-Marsal, Pierre-Etienne Flandin, and Charles de Lasteyrie.[148]

Aside from Millerand's League and Taittinger's *Jeunesses Patriotes* was the *Redressement Français*, which opposed socialism and sought an *Union Nationale* to disentangle the executive from parliament. It had supported Poincaré. It had quite a strong social programme and tendencies which could alternatively be characterised as paternalist or fascist.[149] Lucien Romier, who wrote for the Figaro,[150] was a sympathetic member. Amongst leagues one should also mention François Coty's *Solidarité Française*. And in the 1920s Georges Valois's fascist party, *Le Faisceau*. None of these leagues attained any real political importance, though Maurras's *Action Française* did have an impact, particularly amongst the intelligentsia.[151] The only league which did establish a substantial following and which appeared to threaten the regime in 1934 was de la Rocque's *Croix de Feu*. When the Leagues were banned by the Popular Front government in 1936 he founded the conservative and authoritarian *Parti Social Français*,[152] which did gather substantial support. Doriot's more purely fascist *Parti Populaire Français* had perhaps some 130,000 members before the war.[153] It is important to mention these leagues, of which there were others such as Dorgères' *Comité de Défenses Paysannes*,[154] and Marcel Bucard's *Francisme*,[155] in order to illustrate that the degree of political disaffection with the regime

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[148] see Bourgin (1928).

[149] see Bourgin (1928).

[150] see chapter seven of this thesis.

[151] see Beau de Loménie (1965); & Wilson, in, Cairns (1978).

[152] see Kedward (1969).

[153] see Rémond (1982).

[154] see Petitfils (1983).

[155] see Kedward (1969).

was substantial enough to foster the growth of such movements. This is particularly apparent in the rapid growth in membership of the *Croix de Feu* and its successor the *Parti Social Français*.

Doumergue's constitutional reform proposals aimed at strengthening the executive, by giving it the power to dissolve the Chamber of Deputies without Senate approval. The need for Senate approval meant that in the case of a newly elected Chamber, the Senate, which only enjoyed an indirect electoral mandate, would be very reluctant to approve dissolution. Jeanneney suggests that this explains why Millerand did not attempt to dissolve the Chamber in 1924.[156] There was also the precedent of Mac-Mahon's dissolution of 1877, as a result the practice was considered anti-republican. As it turned out, throughout the life of the Third Republic, this was the only occasion when the Chamber was prematurely dissolved. As a result parliaments were effectively fixed term.

Middleton (1932) argued that this explained the existence of several different groups within parliament, variously some 11 to 13, more than the number of national parties which he put at seven. As parliament could not be dissolved, this forced a system of constantly shifting coalitions. There was no way of breaking the deadlock, or for government to appeal directly for a popular mandate in favour of a certain policy, except at election time. This made for fragmented responsibility and made it more expedient for parliamentary groups to manoeuvre in such a way as to pander to the interests of their lobbies and interest groups.

Doumergue's reform proposals would have allowed the executive to prorogue the budget. It would have limited the power of the Chamber to amend finance bills and other budgetary measures. The proposals would have given the executive monopoly power of initiative over financial and budgetary legislation. Middleton (1932) emphasised the power of the parliamentary committee structure, particularly in the Chamber,[157] though the Senate Finance Committee was no less powerful. It was also suggested that the presidential electoral college, which consisted of both chambers meeting jointly at Versailles, be widened to include representatives of social partners and local and municipal representatives, presumably to lend the presidency a mandate which would not solely derive from parliament.

[156] see Jeanneney (1977).

[157] Quoting Middleton (1932) on the committee system..."which have been so used as radically to diminish Governmental initiative in legislation." p.159.

Such a reformed electoral college would serve to enhance the autonomy of the presidency. An electoral college along similar lines was introduced at the beginning of the Fifth Republic, and was subsequently altered to allow direct presidential elections, fulfilling de Gaulle's neo-Bonapartist aspirations.

Mouré points out that Reynaud supported constitutional reform measures in order to lend more authority to the executive and facilitate the process of deflation. Paul Reynaud had supported such a policy since March 1934 and in May 1934 he, "suggested that Doumergue exploit his current popularity and the Treasury recovery to dissolve the legislature and call new elections."[158] However, as we have seen, Doumergue failed to act decisively enough.

Parliament, in 1934, was clearly in no mood to surrender its authority and with the advent of the Flandin government (November 1934-May 1935) parliamentary reform was effectively buried. Flandin proposed to follow a reflationary policy on gold, which failed. He fell when his request for decree-making financial powers to staunch the financial crisis, which constituted a policy reversal, was rejected by the Chamber. His government made way for Laval, who secured the authority.

This experience illustrates a recurring feature of the whole inter-war period, that parliament (both chambers in this context) would be selective in its grant of decree-making powers. Refusal brought about the fall of governments both of the left and right, though Flandin had lost the confidence of the right over his financial policies. The proposed decree-making powers in the financial field, which he had requested, constituted a reversal of policy and the right preferred to reserve their support for a new candidate: Laval. Tardieu (1935) later expressed his disappointment in Flandin, whom he had originally brought into government, stating that he had implemented the policies of the radicals.[159] Resort to decree-making powers also illustrates the recurrent inability to construct a parliamentary

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[158] see Mouré (1991) p.200. Mouré uses this episode to put Reynaud's policy stance in perspective and to demonstrate that Reynaud had at first supported deflation before moving towards a position which pointed to the inconsistencies of government deflationary policy married to protection and agricultural price support schemes, whilst making clear that another alternative was available, viz., devaluation accompanied by a credible fiscal package aimed at balancing the budget (q.v., his speech of 28/6/34 delivered in the Chamber of Deputies). Mouré also notes that Reynaud was not an advocate of floating, but supported a return to a lower gold par (see Mouré 1991, p.204; and chapter seven of this thesis).

[159] Tardieu (1936) states that he refused invitations to participate in the Flandin, Bouisson and Laval governments which followed Doumergue's resignation.

coalition to legislate necessary economic measures. In a sense, the grant of decree-making powers shifted the responsibility for any unpopular measures away from parliament. Laval also fell before the Senate, but this was on the issue of constitutional reform which would have reduced the power of the Senate and the Chamber. The radicals in both assemblies were wary of an increase in executive authority and jealous of initiatives which would erode their power.

Amongst reformers was also André Tardieu. An innovative politician of the right who, as Prime Minister in 1929, had supported a public works programme. This was adopted in a very diluted form in 1932, as the "*Marquet plan.*"[160] Kuisel dubbed Tardieu a technocrat,[161] whilst Rémond (1982) argued that his political orientation was Orleanist. Neither judgment is incompatible,- one should recall that Louis-Philippe's reign saw the ascendancy of Saint-Simonism which is in many ways the forerunner of technocracy.

Tardieu favoured a parliamentary system closer to the British, with a first-past-the-post constituency-based electoral system, with a single ballot, unless any one candidate failed to gain 25% support. In which case a second ballot would be conducted. He argued that this would foster a two party system, because of the electoral premium it would give large and well organised parties. Tardieu hoped to construct a centre-right party which would encompass the radicals. However, it is conceivable that his proposed reforms might have produced a three party system. Tardieu (1936), though, condemned the political establishment for killing off proportional representation, first introducing it in adulterated form in 1919, rescinding it in 1927, and burying it in committee in 1936. This seemingly contradictory position on electoral issues can best be understood as a dig at the political cynicism and expediency of the political establishment and also, perhaps, at the way the various electoral systems had tended to play in favour of the radicals which gave them inordinate influence as the lynchpin of any coalition.[162]

Tardieu who is sometimes referred to as Poincaré's political successor, developed a critical agenda of constitutional reform proposals. Tardieu's reforms aimed at freeing parliamentary deputies from interest groups. He and Halévy argued that organised pressure

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[160] see Jackson (1985).

[161] see Cairns (1978).

[162] see Tardieu (1936).

groups were a particular characteristic of the radical party with local committees exercising an inordinate influence.[163] Tardieu argued that those forces most associated with the revolution had, through their political practice, brought about a new feudalism. Tardieu and Halévy were particularly scathing of the influence of committees and free-masons, which Tardieu argued had gone over to radicalism in the 1890s.[164] Halévy suggested, ironically, that the expression *Cartel* was a particularly apt label for the radicals as it clearly represented the nature of the radicals, a group brought together, he argued, to serve their own interests. Later it was averred that this influence was increasingly superseded by that of party cells and unions.[165]

Tardieu defended himself against the charge that his proposals were authoritarian, rather they aimed at freeing the parliamentary deputy and separating the branches of government from the captive hold of parliament. The view that the executive had been captured by parliament was also expressed in Siegfried's (1956) comparative study of the Third and Fourth Republics.[166] Tardieu argued that these were not reactionary, but necessary reforms to save the republic from reaction. In his analysis Tardieu often decries parliament, as others did (e.g., Joseph-Barthélemy) for its failure to regard the collective interest,- a dangerous argument for an advocate of individualism. Rather, he should have rested his argument on the need for the liberal state to be strong to oppose collective interest groups.

Both Tardieu and Halévy were particularly pessimistic though on the prospects of achieving the mooted reforms. Tardieu himself argued that he did not press the initiative as Prime Minister as he knew that he would not have secured the necessary support to convene a National Assembly to reform the constitution. Both pointed out that one could hardly expect the radicals to support such a programme of constitutional reforms when the system worked so well in their interests and guaranteed them virtual continual government

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[163] see Halévy (1934).

[164] Quoting Tardieu 1936, "*Une nouvelle Eglise est née,- l'Eglise des comités et l'Eglise des partis, qui va dicter son Syllabus.*"

[165] see Tardieu, Alerte aux Français.

[166] Quoting Siegfried (1956), "*La tradition parlementaire est celle d'une assemblée de contrôle. La IIIe République avait fait évoluer cette conception dans le sens d'une assemblée inspirant et dirigeant l'exécutif.*" (p.215).

representation or influence. Tardieu was equally dismissive of governments of National Union pointing out that this had worked only under Poincaré. His own experience of participation in such formulas (i.e., in Doumergue's government of 1934) had left him with a bitter memory arguing that it had only helped salvage the credibility of the radicals who then cynically abandoned ship and later supported the Popular Front when the political tide was turning.[167]

Tardieu's tone is very pessimistic and coming from an ex-Prime Minister betokens a total disaffection with the regime. Tardieu stated that he would never again serve in hybrid coalitions. He was never again to head a government.

Tardieu's attack against the overweening parliamentarianism of the Third Republic is much in accord with our own thesis, viz., that there existed no mechanism to over-ride parliamentary dead-lock ("grid-lock") and that prerogatives had been allowed to fall into desuetude. He points out that the President had never vetoed a parliamentary bill. Tardieu wanted to withdraw the ability of the Chamber to modify finance bills (he quotes Gambetta and Léon Say in support of his case), arguing that a fiscal package would often fall apart even before the Chamber had time to consider it as a whole. Tardieu argued, cogently, that parliament, which had been established to control public expenditure, had, in fact, become the engine of its growth constantly ratcheting it up. Only if the executive authority were restored and electoral reform introduced, with the aim of reducing the number of political parties and giving government an effective majority, could stability be restored both politically and financially. Tardieu also supported the introduction of referenda to allow the electorate to take clear-cut decisions on specific issues and ideas and to re-enfranchise the electorate which, though nominally sovereign, had seen its authority captured by vested interest groups in parliament.[168]

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[167] see Tardieu (1936).

[168] Quoting Tardieu in Le souverain captif (1936) being the first volume of La revolution à refaire (which was never completed because of the war), *"C'est un souverain captif, à qui il est interdit de se demander si le régime le satisfait, comme aussi de se prononcer directement sur les problèmes essentiels de la vie nationale."* (p.211). The reference to the inability of the electorate to be consulted on the nature of the regime is a reference to the constitutional amendment of 1884 forbidding the electorate from questioning the republican nature of the regime and to the absence of referenda which would allow the electorate to be directly consulted on specific issues and ideas.

Tardieu's opinion was that the revolution which was supposed to have replaced the arbitrary and the particular by abstract universalist principles had betrayed these concepts which were in any case alien to the concept of liberty, e.g., the rabid and dogmatic secularism of the republic, and that the meliorist, "progressive"

THE RISE AND FALL OF THE POPULAR FRONT:

The last parliament of the Third Republic (1936-40) saw the victory of the Popular Front. Within the Popular Front, and indeed in parliament, the SFIO was now the largest party. In previous parliaments the socialist party had been the second largest party of the left, behind the radical and radical-socialist party. As a result it was Blum and not Daladier (leader of the radical-socialists from 20th January 1936) who was invited to form a government. Mayeur (1984) states that it was not expected that the SFIO would win more seats than the radicals.[169]

It had been apparent since the May 5th 1935 Municipal elections that the Popular Front would emerge victorious from the parliamentary elections. Laval's deflationary policies *à outrance* were clearly unpopular and there was no expectation of economic recovery.[170]

In fact recovery had begun under Laval's immediate predecessor, the centre-right politician and head of the *Alliance Démocratique*, P.-E.Flandin, though Sauvy (1984) argued that it went largely unnoticed. Flandin, with Germain-Martin at the Finance Ministry,[171] had abandoned Doumergue's deflationary programme and hoped that the economy and especially government revenue would recover with a looser fiscal and monetary stance. It is interesting to note that Germain-Martin was now pursuing a policy completely at odds with

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scientistic hubris born of the Enlightenment had brushed away custom and tradition which acted as natural breaks on the arbitrary. This left open the way to tyranny. This was compounded by the transposition of positivism from the natural sciences to the social sciences (viz., sociology) in the nineteenth century which had further eroded respect for the past and offered an open-ended agenda for institutional and social deconstruction and positive social engineering. It is clear that Tardieu was increasingly leaning towards Maurras' ideas and inclined to condemn much of modernism. However, Tardieu's prediction of the dangers inherent in re-building society from a *tabula rasa*, on rational constructivist principles, would be vindicated under the yoke of Bolshevik tyranny and its various avatars.

Tardieu concluded Le souverain captif (1936) on the following pessimistic note, "*Toute la Révolution a été mensonge aux principes. Et, de même, tout ce qui l'a suivie...La Révolution est à refaire.*" (p.282). This is exactly what the *Révolution Nationale* under Vichy would attempt to do.

[169] Quoting Mayeur (1984, p.351), "*Les radicaux ne sont plus, ni en voix, ni en sièges, la première formation de gauche. Ce verdict n'était pas attendu. Blum, et non Daladier, allait devoir former le gouvernement.*"

[170] see Sauvy (1984). Though Dubief (1976) argued that Laval's deflation killed any incipient recovery.

[171] Germain-Martin was Finance Minister under the radical, Steeg 13/12/30-27/1/31; Doumergue 9/2/-8/11/34; and Flandin 8/11/34-1/6/35.

that which he followed as Herriot's Finance Minister in 1932 and as Doumergue's in 1934.

Flandin's easier monetary stance was part covert. Flandin secured the agreement of commercial banks to discount government paper on the understanding that the Bank of France would provide suitable re-discount facilities, should the need arise. This increased the attraction and liquidity of government paper, and eased the government's treasury position. Flandin had sacked the Governor of the Bank of France, Moret, and replaced him by Tannery, who proved more accommodating. However, Flandin fell, on 30 May 1935, when refused decree-making powers in the financial field which aimed at effecting an economic U turn.[172]

Flandin had lost radical support in parliament.[173] His successor Fernand Bouisson, ex-SFIO and speaker of the Chamber, appointed Caillaux as Finance Minister.[174] He also appointed three Ministers of State, Herriot, Marin and Pétain, but failed to secure decree-making powers and fell within days (1/6-4/6/35).

Laval's ministry, which succeeded Bouisson's, included three Ministers of State, Herriot, Flandin, and Marin. The Ministers of State represented the parliamentary coalition supporting the government, it was nominally a government of *Union Nationale*, though in practice firmly to the centre-right. Laval secured sweeping decree-making powers, but his deflationary economic policies failed.

Herriot resigned his leadership of the radical and radical-socialist party, on 18/12/35, following attacks on the government's foreign policy at a meeting of the radical-socialist party's executive committee.[175] In 1928, when government policy had been similarly condemned by a congress, he had resigned from government instead. Edouard Herriot was succeeded as leader by Edouard Daladier. They were colloquially dubbed "*les deux Edouards*".

Laval's government fell when the radical-socialists withdrew their support following a subsequent meeting of its executive committee on 19 January. The congress condemned Laval's foreign policy (Hoare-Laval pact) which was considered too conciliatory towards

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[172] see Mayeur (1984).

[173] see Bonnefous (1960).

[174] see Dubief (1976).

[175] Bonnefous (1960) vol.5, p.362.

Italy. Laval, who held the foreign minister's portfolio, was keen to prevent Mussolini from forming an Axis with Germany.

Blum had begun the process which led to the fall of the government by tabling a parliamentary motion condemning Laval's foreign policy.

The radicals' action was part opportunistic as it allowed them to defect to the left which seemed increasingly likely to win the next election. Dubief (1976) argued that the communist change of tack on defence had made it easier for the radicals to be party to what would become the *Rassemblement Populaire*.[176] Following the defection of the radicals and Herriot's resignation from the government and that of the other two radical ministers, Laval's government fell on 22nd January. Sarraut, a radical, formed the next government which amounted to no more than a holding operation until the elections in May 1936. The Sarraut government's financial position deteriorated rapidly, and the incoming Popular Front government inherited a fiscal and financial crisis. Dubief pointed out that the Sarraut government marked the end of the broad coalition or *Union Nationale* formula. He defined Sarraut's government as one of "*concentration républicaine*," or mainly radical in composition.

Following the elections and during the one-month inter-regnum before the new parliament was convened on 4th June a wave of strikes began.[177] Thus, when Blum was asked to form a government by President Albert Lebrun (1932-40) on 5th June he inherited a particularly volatile political situation made worse by the workers' euphoric expectations. The resulting social and economic concessions known as the "Matignon agreements" included a 40 hour work week, two weeks paid holidays, and wage increases of 7-15%. However, fear of a socialist government, increased military expenditure and the decision to regularise the previous covert borrowings (*avances occultes*) of the state from the Bank of France made the financial and economic situation increasingly untenable.

Marjolin (1938) argued that the 40hr. week killed the incipient economic recovery, by setting up supply-side rigidities and increasing costs.[178] Devaluation became inevitable and effectively took place with the gold embargo of 26/9/36. Continued financial crisis

[176] Dubief (1976) p.168.

[177] see Dubief (1976).

[178] Marjolin (1938).

prompted Blum to call a pause on 13th February 1937 and finally to ask for decree-making financial powers for the period 14/6-31/7/37 (which effectively would have carried him into September because of the August break). These were denied and the first Popular Front government fell on 21st June 1937. The government fell in the Senate because of radical opposition to his demand for decree-making authority to handle the financial crisis. Caillaux led the opposition.[179]

Kaleçki (1938) argued that the Popular Front should have introduced exchange controls, however the radicals who were an essential ingredient of the Popular Front coalition opposed this. Goguel suggested that the socialists might have been inclined to do so in other circumstances.[180] In popular mythology the Popular Front is depicted as monolithic, however it is important to realise that it was a coalition. This largely explains the seeming policy failings and inconsistencies of the Blum government. One should recall, in particular, that the communists were adamantly opposed to devaluation.[181]

There followed two short-lived governments from June 1937 to March 1938 headed by the radical Chautemps. The first was similar in composition to the first Popular Front government. It fell when he launched an attack on the communists for supporting strikers. As a result the socialists withdrew from the government. His second government was an entirely "radical" government, though it included some *socialistes indépendants* and was supported by the communists and socialists. However, it resigned following the *Anschluss* with Austria.[182] According to Mayeur (1984) this was because it knew that it would not be able to secure decree-making powers to pursue a deflationary policy.[183] The socialists were not willing to grant Chautemps full financial powers.[184] He resigned without being defeated in parliament. The behaviour of the socialists may well have been aimed at bringing Blum back to office. Following the resignation of Chautemps' government, in March 1938,

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[179] Goguel (1946) p.521.

[180] Goguel (1946) p.350.

[181] see chapter seven of this thesis.

[182] see Goguel (1946).

[183] see Bonnefous (1960).

[184] Mayeur (1984) p.359.

Blum was asked to form a government.

Blum attempted to form an ecumenical government of *Unanimité Nationale* or *Union Sacrée*, encompassing all political parties and traditions, such as that which Poincaré as President had been instrumental in bringing about in 1914. This proposed government would have ranged from Marin (*Fédération Républicaine*), to Maurice Thorez (Communist). However, the right, "*parti de l'ordre*", refused to participate in a government which included communists. As a result Blum was obliged to look for a majority with a composition similar to that of the first Popular Front government. It proposed a programme which included exchange controls and a capital levy.[185] It was subsequently argued that this was the first reflationary keneysian programme to be presented in France. Lefranc argued that the programme which Blum proposed was inspired by Keynes' General Theory.[186] Apparently Georges Boris had been instrumental in developing it. Boris argued that the unfortunate international situation provided the necessary climate for a programme of re-armament.[187]

The Chamber supported the Blum government, though Mayeur (1984) pointed out that it lost half the radical vote,[188] but it fell in the Senate. According to Dubief (1976) the radicals in the Chamber knew that the government would fall before the Senate.[189] There was now an alternative coalition to the right and, according to Dubief, the radicals were determined to form a government with the support of the right against the left.[190] Dubief added that this had been the wish of the radicals in the Senate for some time. Allowing the government to fall before the Senate conveniently exonerated the Chamber from responsibility (and particularly the radicals). Blum's fall marked the end of the Popular Front and opened the way for a government of "*concentration*" toward the centre of the political spectrum and later the centre-right.

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[185] see Dubief (1976); and Mayeur (1984).

[186] Lefranc (1974) pp.275-76.

[187] Lefranc (1974) added, "*Pierre-Mendès France, dans la même revue, indique qu'il a rédigé avec Georges Boris l'exposé des motifs du projet déposé par Léon Blum. C'est le premier document officiel français qui soit inspiré de la Théorie Générale et de la théorie du circuit monétaire de Keynes.*" p.276, footnote 1.

[188] Mayeur (1984) p.360.

[189] Dubief (1976) p.216.

[190] Dubief (1976) p.215.

Daladier, now head of the radical-socialist party and former deputy-Prime Minister in Blum's first Popular Front government, formed the next government of *Défense Nationale* and managed to secure decree-making powers to deal with problems of defence, to stabilise government finances and the economy.[191] They empowered him to take necessary measures to resolve the financial crisis and to meet the growing defence needs. Mayeur (1984) pointed out that the Daladier government, which lasted from April 1938-March 1940, was re-shuffled three times, but did not include socialists. In fact since the second Chautemps government there had been a gradual shift of the majority coalition to the centre. This was confirmed by the failure of Blum's final attempt to form a government.

The shift toward the centre-right was apparent when Daladier appointed Reynaud, of the *Alliance-Démocratique*, as Finance Minister. With Daladier we also witness a gradual increase in executive authority,- particularly after the failure of the communist led general strike on November 30th 1938, aimed at protesting against the erosion of the gains realised under the first Popular Front government.

Reynaud, at the Finance Ministry, under Daladier, marked a return to liberal economic policies. His predecessor, the radical-socialist Paul Marchandeau, had favoured exchange controls (as did the dismissed Governor of the Bank of France, de Labeyrie). The departure of Marchandeau marked the all too familiar mid-term switch to a centrist coalition, or "*majorité de concentration.*" However, the trend toward increasing executive power and the swelling ranks of de la Rocque's *Parti Social Français*,[192] the successor to the *Croix de Feu* which had been banned along with the other leagues in June 1936, already pointed toward *L'Etat Français* of Vichy. One should note, however, the limits of de la Rocque's constitutional threat. When the right-wing Leagues were banned by the first Popular Front government de la Rocque formed the *Parti Social Français* which became a parliamentary party. Like Boulanger de la Rocque did not press confrontation to its extreme. With the collapse of the Third Republic that section of individuals and groups[193] who had never reconciled themselves to the Republic and those who had gradually become disaffected

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[191] Mayeur (1984) p.362.

[192] Mayeur (1984) p.376.

[193] see Siegfried (1956).

realized that their hour had finally come.[194] Vichy would witness the ascendancy of many of these currents.

CONCLUSION:

If we survey this whole period one is struck by the inability of the political class to tackle the recurrent economic crises, which were but the material expression of a continual political crisis. The only exception being Poincaré's premiership between July 1926 and July 1929, which marked a return to sound finance and a positive current balance of payments. On other occasions, when political figures did attempt to resolve the economic and political crisis, the conjunction of economic circumstances were unfavourable and temporary political alliances soon deserted them.

As a measure of the bankruptcy of the Third Republic, in its late life, one should but reflect that both during the crisis of the re-militarisation of the Rhineland in 1936 and the *Anschluss* in 1938, France was undergoing a political crisis and effectively leaderless whilst Germany under Hitler pursued its "revanchist" and irredentist (both geographically and ethnically) foreign policy.

The Third Republic's parliamentary system during the inter-war had its deficiencies. Foremost was the inability to resolve recurring institutional deadlock between executive and parliament, and between parliamentary assemblies. The electoral system and political culture could not produce a cohesive and lasting governing majority and the constitutional mechanisms did not exist to force a resolution of these conflicts either way.

Amongst features internal to the parliamentary process one might mention the ability of parliament to amend finance bills. The need to have bills passed in similar form in both Chambers, the so-called "*navette*", which led to a protracted budgetary process.[195] The absence of mechanisms to resolve policy divisions either way. The "*navette*," an expression of the effective dual responsibility of both Chambers, exacerbated the fiscal crisis and resulted in recourse to such budgetary expedients as provisional twelfths,- a reflection of the budgetary and political deadlock,- and borrowing from the Bank of France. This was a

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[194] see Rémond (1982).

[195] cf., the difficulties over the devaluation bill in chapter nine of this thesis.

constant feature until 1926 and recurred from 1930 onwards as the combination of depression and deflation hit the French economy and budget deficits returned.

However, it is not clear that parliamentary reform alone would necessarily have much altered the political balance, which was rooted in the political culture and set of historical references. Tardieu's suggested introduction of a first-past-the-post electoral system could have fostered the growth of two cohesive alternative parties of government, but this is not certain (q.v., the Fourth Republic[196]). However, a strengthened executive with power of dissolution, possibly drawing its legitimacy from a direct electoral mandate would certainly have shifted the political balance of power away from parliament and may well have been the necessary lever to force a solution to recurrent political and economic crises, particularly if combined with electoral reform (without electoral reform it is possible that dissolution would have returned a similarly fragmented Chamber exacerbating the discredit of parliament). However, parliament would most certainly not have accepted this. One has but to recall the initial parliamentary reaction to de Gaulle's Fifth Republic, which President Mitterrand was to dub a "*coup d'état permanent*" to understand the sort of political reaction which such a reform would have elicited. The rise of the right-wing leagues point to a sense of deep-seated dissatisfaction with the political system (which amongst some quarters, e.g., Charles Maurras' *Action Française* had never been absent), and recourse to decree-making powers illustrate the institutional and political deadlock. One should note that de la Rocque's successor to the banned *Croix de Feu*, the *Parti Social Français*, had some one million! members/supporters (*adhérents*) just before the outbreak of the war[197] and was expected to win a hundred seats in the 1940 elections.[198]

Mayeur (1984) pointed out that it was under Poincaré that decree-making powers were first delegated in the financial field. These were used by Poincaré in the spring of 1924 and July 1926. Doumergue in 1934, Laval in July 1935, Chautemps in July 1937, Daladier in May and October 1938 and April and September 1939, would all resort to this procedure. Mayeur also indicates that with time the mandate was broadened to defence. Mayeur adds that from 1/3/34-1/7/40 France was under a regime of decree laws for 31 out of a total of

[196] see Siegfried (1956).

[197] Mayeur (1984) p.376.

[198] see Rémond (1982).

76 months. Their incidence would increase, until finally all executive authority was vested in Pétain on 10/7/40, completing this process.[199]

The rise of the Leagues is symptomatic of the exclusion (and disillusion) from the Republic's parliamentary life of tendencies within the right, such as *Action Française* which did not accept the Republic.[200] This division within the right between those accepting the revolution and the republican regime and those who rejected it (who would rally to the *Révolution Nationale* under Vichy) fragmented the right. As a result the right was not fully represented in parliament and those republican parties of the right in parliament had to rely on radical support. The parliamentary right were wedded to individualism and as such rejected cohesive party discipline. The further one moved away from the left of the political spectrum the more independent groups and members became. There always remained a rump of independent political figures who were hardly reconciled to the republic, certainly as it stood. The most disciplined political party were the communists, who took their orders from Moscow. The phenomenon of the Leagues can also paradoxically be explained by the extra-parliamentary history of the republican regime where so often politics had been determined by the action of the mob on the streets of Paris and Versailles.

Given the fragmented nature of the parliamentary groups and parties the radicals formed an essential ingredient of any coalition, either of the centre-right or centre-left. We have already alluded to the difficulties posed by radical participation in either combination. Just as the right was divided, so was the left. The communists refused to co-operate with the socialists until orders were given from Moscow to join in the *Rassemblement Populaire*. Even then the Marxist parties, viz., the SFIO and the communists, had to rely on radical support and the marxists remained divided with the communists refusing to participate in government. Radical participation seriously impeded any leftist agenda, and the communists rejected devaluation which they saw as a means of reducing real wages. These difficulties explain some of the oft-criticised policy actions and failings of the first Popular Front government.

As a final reflection on the inter-war French polity it is interesting to note Olé-Laprunne's thesis (1962) that so-called political instability effectively masked the stability of

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[199] Mayeur (1984) p.378.

[200] see Siegfried (1956); & Rémond (1982).

the governing political personnel.[201] This permanence of individuals and by implication their political groupings, however elusive, points to the nature of the problem, viz., the inability to break the political deadlock. It also reflects the extent to which the political regime was captured by parliamentary parties and groups.[202] There was no mechanism for the executive to appeal directly, either through dissolution of the Chamber or a referendum, for its own mandate.[203] Though the political process was captured by the parties, paradoxically it prevented any one party from asserting itself, and the electoral system precluded the (all male) electorate from exercising a specific, and clear-cut choice. The electoral blocs which were formed proved to be heterogeneous and soon fragmented leading to periods of instability. No constitutional mechanism existed, in practice, to resolve this (excepting the periodic and *de facto* fixed timetable of elections), until a new governing coalition majority could emerge within parliament from the gaggle of parliamentary groups and vested interests. The political system exacerbated political tensions embedded within the political culture and effectively disenfranchised the electorate most of the time.[204]

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[201] see Soulier (1939). One should add that to any seasoned observer of the Italian political scene, which is also often characterised as being prone to instability, whilst in fact the underlying problem lies more in political immobilism and inertia,- France during the inter-war period appears in many ways astoundingly familiar. One might mention that Italy, as a result of its political sclerosis, suffers from an intractable budget deficit.

[202] see Tardieu e.g., <u>Le souverain captif</u> (1936).

[203] Quoting Olé-Laprunne (1962), *"A une époque où les chutes de gouvernements deviennent de plus en plus nombreuses, nous constatons, ainsi que nous l'avons noté précédemment, que l'instabilité ministérielle accrue n'est pas une cause supplémentaire d'introduction des nouveaux ministres. Bien au contraire! la multiplication des crises ministérielles hâte le processus de "confiscation" du pouvoir."* p.31. And, *"Réaction spontanée d'un régime politique en déséquilibre permanent, la stabilité des ministres se présente comme un phénomène de compensation: la permanence des hommes comblant dans une certaine mesure, le vide crée par les crises gouvernementales."* p.83.

[204] see Tardieu (1936).

CHAPTER 2

THE INTER-WAR MONETARY SYSTEM

"L'or est la première des monnaies fiduciaires."[1]

INTRODUCTION:

An understanding of inter-war currency experience requires that we look back to the pre-1914 international monetary regime, and that we single out the dominant features of what was dubbed the gold standard. Analysis of the nature of the gold standard divides into three strands of thought: that it was a managed standard[2] - (see Strange, de Cecco, Scammell, Cassel, Ford,[3] Bloomfield, Eichengreen Golden Fetters) -,[4] the second view often espoused

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[1] Simiand quoted in Pirou (1938) p.124. However, given Pirou's distrust of public authorities and his adherence to a liberal economic order he admitted that he preferred to see government restrained by the gold standard, acknowledging its pitfalls. Considering that its advantages outweighed its disadvantages. Pirou continually stressed the psychological factors which underpin the acceptability of a currency.

[2] McCloskey & Zecher (1984) would argue that national authorities could not control the domestic money supply. This would be determined by the demand for real cash balances. However, if one assumes a certain degree of control over domestic interest rates, because of market imperfections, and the need on the part of domestic financial, prudential and other institutions to match assets with liabilities, then it might be assumed that the authorities could affect economic activity and thereby the demand for real cash balances. Furthermore, "real" variables have only any sense *ex post*, i.e., in a timeless world (therefore non-existent) in which uncertainty has been eliminated. Dick & Floyd (1992), however, assume that interest rate parity holds through risk adjusted capital market arbitrage and therefore deny capital market segmentation.

[3] Quoting Ford (1960), "The pre-1914 gold standard may be seen as a sterling standard largely, with London as its pivot, which had gradually developed in the nineteenth-century." reproduced in Eichengreen, The Gold Standard in Theory and History. The inter-war financial press concurred in this interpretation of the pre-war gold standard, "The gold standard of pre-war days was really a sterling standard, with the United Kingdom as the leading member and ever anxious to lend where there was need. After the war the United States became the dominating influence in the system, with the United Kingdom holding on uneasily." The Financial News, 30/9/36.

[4] Quoting Bloomfield (1959), "But it does indicate that discretionary judgement and action were an integral part of central banking policy before 1914, even if monetary management was not oriented toward stabilisation of economic activity and prices in the broader modern sense." p.26. Bloomfield would add that, "Far from responding invariably in a mechanical way, and in accord with some simple or unique rule, to movements of gold and other external reserves, central banks were constantly called upon to exercise, and did exercise, discretion and judgement in a wide variety of ways. Clearly, the pre-1914 gold standard system was a managed and not a quasi-automatic one from the viewpoint of the leading individual countries." p.60. This is a view shared by Eichengreen (Golden Fetters), referring to the pre-war gold standard, "however, there was no

by the advocates of the concept of a managed standard affirm that sterling was at the hub of this managed standard (Scammell, 1985).[5] The latter school is known by students of international relations as the financial hegemon thesis. Both propositions concerning the nature of the gold standard follow from the N-1 problem in a fixed exchange rate regime, viz., that it be characterized by a Stackelberg leader against which all other exchanges are set, or a co-operative/managed regime.

The third school is more recent, but in its neutrality hypothesis it is closer to the classical, superficially, apolitical model of Hume, viz., the McCloskey & Zecher thesis that sterling did not fulfil its putative linchpin role in the international monetary system and that gold distribution and trade flows reflected the relative demand for money. A model with somewhat similar assumptions, but emphasising the primacy of capital flows dictated by savings/investment imbalances in driving the current account has been developed by Dick & Floyd (*vide infra*).

The third category of gold standard exegetical model rejects the idea of the centrality of sterling in the international monetary system, and argues that if it did play an important role this was only in its function as a unit of account used by the City of London acting as an international clearing house for capital.

As we shall see it was to a very great extent the inability of the general financial establishment to comprehend the singularity of the ante-bellum monetary regime which led to the belief that a simple return to gold would, of itself, result in a return to equilibrium. This belief is associated with the Cunliffe Committee Report.[6] Though one should note that

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mechanical following of gold standard rules rather discretionary behaviour was integral to the system."p.65.

[5] Quoting van B. Cleveland, "...The success of the gold standard before 1914, then depended on its political asymmetry. Britain, or more precisely the Bank of England, was not merely *primus inter pares* but also exercised a measure of central control over monetary conditions throughout the gold standard world." in, Rowland (1976) p.23.

[6] "Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be very grave danger of a credit expansion in this country and a foreign drain of gold which might jeopardise the convertibility of our note issue and the international trade position of the country. The uncertainty of the monetary situation will handicap our industry, our position as an international financial centre will suffer and our general commercial status in the eyes of the world will be lowered. We are glad to find that there was no difference of opinion among the witnesses who appeared before us as to the vital importance of these matters." From abridged version of the Cunliffe committee report, in, Eichengreen ed., The Gold Standard in Theory and History (1985) p.175. The Macmillan committee appeared far less dogmatic, "Central banks, in whose hands the working of the international gold standard has been vested, no doubt largely recognise that in many respects the purely

the third category of gold standard model in many ways conforms to the idealised Cunliffe Committee interpretation.

This chapter aims to demonstrate that not only was the inter-war system more precarious than its predecessor, but that it was also based on false premises, viz., the automaticity of the pre-war gold standard. It is important to realise/deconstruct the nature of the gold standard myth, as perceived by French policy makers in particular. This myth was a constant referent, and an essential ingredient in the liberal/individualist economic paradigm, born of 18th century meliorism,[7] which posited the natural self-equilibrating tendencies of economic activity. Deflation was perceived as part of this process of return to "equilibrium" which had been disturbed first by war and thereafter by inflationary credit policies in the anglo-saxon money centres, viz., London and New York. According to French analysts and policy-makers this explained the asset bubble which developed on Wall street as well as sterling's forced departure from gold. French analysts (*q.v.* Aftalion) argued that loose credit policy in the US had caused the stock market boom and that UK monetary policy should have been tighter given the Bank of England's gold reserves. The gold standard rules had been offset by open-market policies and failure to allow gold reserve flows and the demand for cash and transactions balances regulate the growth of credit.

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traditional and empirical rules by which their conduct was guided in pre-war days are no longer adequate as guides of action in present-day conditions...," Macmillan Cmttee. report, in, Eichengreen (ibid.) p.190. Keynes (1923) pointed out that the Cunliffe cmttee. report had been drafted before the cessation of hostilities, that exchange controls had not yet been lifted, and large exchange fluctuations had not yet taken place. He also alluded to the fact that the US Treasury had, as of yet, not accumulated a large hoard of gold, to which some would blame the sharp fall in commodity prices in the early post-war years. Keynes concluded, with typical hyperbole, "The Cunliffe Report belongs to an extinct and an almost forgotten order of ideas." Keynes (1923) p.195.

[7] In its most acute form the liberal economic model might be dubbed the economics of Dr. Pangloss. A particularly virulent form has recently held the ascendant under the guise of new-classical macro-economics, much of which is couched in hyper-real ideal types such as, constant market clearing, inter-generational arbitrage, inter-temporal substitution of leisure for work, etc. The idealised nature of many of these assumptions is paradoxically at odds with the empirical philosophical foundations on which classical political economy rested. In these models reality, viz., time and uncertainty, comprise grievous intrusions. Much of the blame for the models must be laid at the modernist desire for quantification, hence the reductionism of many of the assumptions. It is therefore appropriate that this school should be dubbed Panglossian as the model for Dr. Pangloss was the father of the differential calculus, Leibnitz (*q.v.*, Voltaire's Candide). The world of Descartes (a trained mathematician) and Walras (an engineer) is an ethereal, mathematical, solipsistic/individualist one in which time and place, traditions and customs (e.g., going wage) have no place. Often the very concept of equilibrium becomes tautological, being the optimum state by the very fact of being that at which the economy finds itself, the expression "equilibrium" also carries falsely comforting connotations of rest, equipoise, etc.. This is not to deny, though, the heuristic value of these models, rather to admonish the increasing scholastic nature of these confabulations.

Deflation was necessary as part of a purgative equilibrating process.

This belief in the equilibrating nature of the economy, in a quasi-Newtonian frame, largely explains the inaction of French policy-makers. Intervention could only be an arbitrary intrusion on the operation of natural forces. The price of gold in local currency terms (which it could be argued was an arbitrary intervention cf., free banking school)[8] would constitute the fixed anchor, the eternal constant, around which activity would gravitate and contracts be denominated in,- all else would follow. Free markets externally, viz., free trade, and domestically, formed the essential ingredients of this liberal world view which exercised particular influence amongst the French political and economic establishment.[9] In this system, gold was the N-1 currency against which all others would peg. It may be asked why the UK authorities returned to par, why not accept the new "equilibrium" price relations? There is a wide literature on this subject which is explored in chapter three. However, one of the more salient reasons was what present day economists would recognise as reputation and credibility.[10] Sterling's reputation was such that it did not seem that the cost of deflating the domestic price level was such as to be worth sacrificing the old sterling

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[8] Milton Friedman (1961) has also been critical of governments arbitrarily fixing a price for gold arguing that this constitutes a departure form free market principles. Quoting Friedman, "...the use of gold as money, which I shall call a "real" gold standard; governmental fixing of the price of gold, whether national or international, which I shall call a "pseudo" gold standard." (p.67) It is interesting to note here that his views are closer to Hayek's free banking proposals than his later advocacy of a firm central bank control and monopoly of the money creating process which should aim at stabilising the value of the currency against an average index,- for a critique of, "the fashionable pseudo-quantitative economics of averages with its arguments running in terms of national "price levels", "purchasing power parities", "terms of trade", the "Multiplier" and what not," see Hayek (1937) p.45. Friedman adds, "It is vitally important for the preservation and promotion of a free society that we recognize the difference between a real and pseudo gold standard. War aside, nothing that has occurred in the past half-century has, in my view, done more to weaken and undermine the public's faith in liberal principles than the pseudo gold standard that has intermittently prevailed and the actions that have been taken in its name." (ibid.) Friedman is of the opinion that had the US authorities been on a pure gold standard, or gold certificate standard, they would not have tightened policy, as they did during the banking crisis of 1930-31, as gold reserves, owing to the previous sterilisation of gold inflows, were high. Similarly had the authorities pursued a fixed nominal price rule policy would not have been as perverse. The pseudo gold standard produced the worst possible outcome.

[9] Though France is often associated with Colbertism and mercantilism there was a strong current of liberal thought which found prominence from the middle of the 19th century and is illustrated by the writings of J.B.Say, F.Bastiat, and M.Chevalier. This liberal paradigm was dominant amongst French policy-makers during the inter-war years.

[10] see Eichengreen, Golden Fetters.

gold parity,[11] and of course it was expected that prices in the US would rise reducing the burden of adjustment.

In the international arena there were of course dissentient voices who argued that the gold standard owed its qualities to exceptional circumstances, viz., the central role played by sterling.[12] Hawtrey would express the fear that a return to pre-war parity might spark a deflationary scramble for gold. Both would point out that the purchasing power of gold itself was far from stable.[13] However, French policy-makers broadly adhered to a text-book model of the ante-bellum gold standard which, as we will argue, did not conform to reality.

The impact of mis-aligned exchange rates, and the prevalence of an increasingly fix wage price environment,[14] whilst commodity prices retained their flexibility, explains the emphasis placed in the inter-war economic literature on the necessity of redressing the imbalance between wholesale and retail prices. The former can be considered a proxy for the traded goods sector and the latter the non-traded goods sector,- the ratio between the two being the real exchange rate. Eichengreen argues that devaluation lowered the real wage and thus the real exchange rate.[15] This was partly affected by raising the price of commodities

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[11] Sterling's gold parity was set by Sir Isaac Newton in 1717 as Master of Mint. It is interesting to note that the intention was that Britain would continue to have a bimetallic standard. However, Newton miscalculated the rate of exchange between gold and silver. This resulted in silver remaining relatively overvalued and as a result of "Gresham's law" gold drove out silver and became the dominant currency - one might add that with increased economic prosperity and international settlements gold's relative advantage increases considerably as for the same value it was approximately 15 times less bulky, though as a result of its greater bulk, a silver standard would enjoy wider export and import points allowing greater exchange rate flexibility. The gold standard was only suspended during the Napoleonic Wars between 1797 and 1819-21.

[12] cf., Cassel.

[13] This was recognised by Francis Delaisi (1936), "*Pendant un siècle, depuis que l'usage du billet de banque s'est généralisé, on a vécu sur cette illusion qu'une monnaie est stable quand elle représente un poids d'or toujours le même. S'il est aujourd'hui une chose démontrée par l'expérience, c'est l'extrême variabilité du poids d'or que l'on obtient à quelques années de distance pour une même quantité de marchandises.*" p.160. Delaisi advocated a devaluation against gold to raise commodity prices nearer their former levels. In order to avoid inflation, and promote international recovery, he favoured crediting the paper profits to a common fund to stabilise currencies, part of which would be lent to countries in default, thereby reviving international credit. Once currencies had been stabilised the need for protection would disappear.

[14] Eichengreen has pointed out, though, that research has tended to demonstrate that wages were not necessarily more rigid during the inter-war years. However, what is more to the point is that government would become increasingly concerned with the levels of employment and the state of domestic activity. (see Eichengreen, introduction to, The Gold Standard in Theory and History). One should note that the extent of the shock was greater. Strakosch (in, Gayer, 1937) suggested that a degree of price flexibility was lost with the increased prevalence of industry and services at the expense of agriculture.

[15] see Golden Fetters.

and traded goods in local currency terms,- a policy which Hawtrey advocated. Clearly when the communists, in France, rejected devaluation on the grounds that it would reduce the real wage, they had understood the nature of the proposed operation.[16]

The difficulties of adjustment were made more acute by a rigid adherence to a balanced budget rule which, along with the effects of an over-valued currency, imposed a deflationary macro-economic stance in the UK and France in the 1920s and 1930s respectively.[17] Problems of international economic adjustment in the inter-war years were compounded by reparations payments and war debts. These difficulties were exacerbated by failure of countries such as France and the US to recycle surpluses, and by the reduction of international liquidity which their very substantial acquisitions of gold imposed. This so-called maldistribution of gold imparted a further deflationary twist.[18] Gold reserve recipients sterilised its effects on the domestic money supply,[19] or rather did not allow the specie inflow to have multiplier effects on the credit structure, as a result the burden of adjustment fell on debtors. These problems became worse following the sterling devaluation of September 1931 as the Bank of France reduced its foreign exchange holdings to virtually naught,- Eichengreen's thesis is consonant with this view.[20]

In fact the gold standard, as it was described in 18th and 19th century economic literature (cf., David Hume, David Ricardo, John Stuart Mill), owed much of its character to the pre-eminence of the pound sterling. The gold standard as an international phenomenon had only a short life from circa 1879 to 1914. Furthermore, some countries were on a silver standard right into the inter-war period, i.e., China and Mexico. Others converted from a silver to a gold standard in the 1870s, e.g., Germany. Eichengreen points out that most Latin American and American countries that went on gold did so in the final decade before

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[16] Eichengreen (Golden Fetters) has shown that in fact the reason devaluation failed to have beneficial effects in France in 1936 was because it was accompanied by inflationary policies and supply-side rigidities, e.g., a shorter working week. Quoting Eichengreen in the context of the French devaluation and its disappointing effects, "Production costs rose and economic activity fell in the wake of devaluation, precisely the opposite of the response in other countries. In conjunction with increased demand, French policies to restrict supply produced inflation rather than economic recovery."p.349.

[17] see Appendix for real exchange rates.

[18] see chapter ten of this thesis.

[19] see Eichengreen Golden Fetters, p.248.

[20] see Golden Fetters.

the First World War, and the Latin American countries tried to maintain silver in circulation too.[21] In the US the Gold Standard Act was only passed in 1900. Austria-Hungary maintained a gold exchange standard, supporting her exchange rate by purchases and sales of foreign exchange. France which was, *de jure*, on a silver standard maintained a "limping gold standard."[22] France only went on the gold standard *de jure* with the Poincaré stabilisation in 1928. Those countries which did return to the gold standard in the inter-war years chose a gold bullion standard. The Bank of France would only deliver gold in Paris, in the form of gold ingots worth some 215,000 francs, and the Bank of England in minimum quantities of 400 oz. of fine gold.[23]

Hayek has argued that the concentration of gold in central bank vaults meant that the post-war gold standard lost much of the automaticity of its pre-war counterpart. According to Hayek in the pre-war system a gold drain would have an immediate impact on the domestic currency circulation. The money supply being immediately and directly reduced, or increased, as a result of fluctuations in the trade and current account balance. However, Hayek has taken the text-book model at face value. The beneficial effect, though, of such a concentration of gold in central bank vaults is that it increased the money multiplier associated with any given level of world monetary gold. However, to the extent that concentration of gold in central bank vaults increased the multiplier it made it more likely that the authorities would adopt measures to prevent cumulative effects on the country's credit structure. In such circumstances it would be more likely that the central bank would hold an additional gold reserve cushion or liabilities of the gold centre, e.g., sterling balances. For, given these multiplier effects, central banks were more prone to sterilise gold inflows and outflows on the monetary base and, thus, prevent destabilising inflation and deflation of credit. The perceived instability of this "gold nucleus standard"[24] would prompt some to call for a full gold standard (Hayek; Rueff) or 100% money (I.Fisher). Though Fisher's initiative was also aimed at stabilising the purchasing power of gold against an average price index, a policy to which Hayek (1937) was thoroughly opposed on the grounds

[21] see Golden Fetters, p.60.

[22] see Sédillot (1953).

[23] see Kisch & Elkin (1930).

[24] see Hayek (1937) Lecture II.

that it would distort the relative price mechanism.

One should note that in a monetary system in which gold acts only as a reserve "rules of the game" and the role of interest rates becomes more important in regulating the demand for credit, as opposed to a pure (ideal) gold standard in which the effects on the domestic money supply of an adverse balance of payments are direct. It is the latter, a gold specie standard, which Hayek had in mind in which the role of financial intermediaries and the rate of interest are absent. Such a model does not conform to the 19th century gold standard, which was increasingly characterised by the use of credit money, viz., cheques.[25]

France treated its gold reserves under Bank of France Governor Pallain (1897-1920) very much as a war chest. This proved appropriate as these reserves were later to serve as collateral to secure international loans during the First World War. This policy was adopted in order to maintain the exchange rate and prevent the terms of trade turning too much against France at a time when import needs were so great. France, under the pre-war standard, had resorted to all sorts of devices to help protect its gold reserves and prevent the franc from reaching its gold export point, viz., when the fall in the franc's exchange rate would make gold arbitrage operations profitable. Such arbitrage operations,[26] according to the classical model, would involve exchanging francs at the Bank of France for gold, exporting the gold and delivering it to the central bank whose currency had appreciated beyond its gold import point. The gold would be used to obtain the currency which had appreciated. These balances would be sold for French francs. The francs in turn would be presented at the Bank of France for conversion into gold. In theory this process of arbitrage would continue until the price level in the country importing the gold had risen beyond purchasing power parity and the resulting reversal of trade would gradually strengthen the trade balance of the country exporting gold, whilst the importing country would witness a deterioration. This would tend to reverse the exchange rate trends and equilibrium would be restored,- at least according to the classical price specie flow mechanism. In this model equilibrium is achieved by means of arbitrage in the goods market and relative elasticities determine the terms of trade.

In a model characterised by credit and financial intermediaries gold flows would

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[25] *q.v.*, Triffin.

[26] see T.A. Clark (1984) for an excellent technical account of gold arbitrage operations.

trigger opposite movements in domestic bank rate which would both attract capital and reduce/increase domestic absorption and, hence, restore equilibrium. But, as soon as financial intermediaries are introduced, viz., the central bank, the ideal-ised gold standard loses much of its appeal as an impersonal automatic mechanism. Financial intermediaries, particularly a central bank controlled by government, open the way for exchange management, hence the need for "rules of the game".

However, as some later commentators have pointed out there appears to be a fundamental contradiction between the law of one price and Hume's price specie flow mechanism which posits,[27] as part of the equilibrating process, a departure of prices from purchasing power parity. According to Hume's model, currency exports/imports would alter relative international prices which would in turn spark equilibrating real flows until a new equilibrium had been reached. McCloskey has argued that the Friedman & Schwartz transmission mechanism was similar to Hume's.[28] Certainly the domestic transmission mechanism remains unexplained in both Hume and Friedman. Neither provides a description of the role of financial intermediaries. However, the Friedman & Schwartz (1963) and Eichengreen (1992) thesis, that the depression originated in the United States and was transmitted across the fixed exchanges is not necessarily incompatible with the law of one price if one accepts that much of the world was a price-taker and the absence of instantaneous clearing.

Greater emphasis was later put on the role played by relative discount rates,[29] than

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[27] see, "The Success of Purchasing-Power Parity: Historical Evidence and Its Implications for Macroeconomics," by McCloskey & Zecher, in, Bordo and Schwartz, eds., <u>A Retrospective on the Classical Gold Standard, 1821-1931</u>, (1984).

[28] Friedman & Schwartz (1963) argue that the depression spread from the US across the exchanges. Falling US prices and fixed exchange rates meant that the rest of the world imported deflation. The McCloskey & Zecher model (1984) rejects this analysis on the grounds that prices cannot depart for long from purchasing power parity because of the law of one price.

[29] Quoting Bloomfield (1959), "In Great Britain, for example, an increase in discount rates, when "effective" in the market and not offset by corresponding increases elsewhere, tended to induce net inflows of capital by contracting the outstanding volume of London's acceptance and other short-term claims on the rest of the world, attracting liquid foreign balances seeking temporary investment in London, by stimulating arbitrage operations in securities quoted in London and abroad, by delaying the flotation of foreign securities quoted in London and the transfer abroad of the proceeds of previous flotations, and in other ways. This widespread reaction to changes in the Bank of England's discount rate on the international flow of capital helps, in part at least, to explain why Great Britain was able to operate effectively on so small a margin of gold reserves before 1914, even though frequent and substantial rate changes were necessitated." p.42.

The "hegemonial" nature of sterling made for more frequent rate changes. These are traced in Hawtrey price specie flow. A variant of this model, which lays stress on the commanding role of the London discount rate, because of the UK's net creditor position and role in world trade finance, is open to the accusation that it views the adjustment process solely from the centre and ignores adjustment costs borne by the periphery.[30]

According to the symmetric version of this model, changes in relative discount rates were more important than the effect of bullion shipments on domestic monetary aggregates.[31] As a country lost gold, or the currency fell to gold export point, money market rates would tighten (the supply of notes would drop, *pari passu*, as notes were surrendered for gold once the currency had reached its gold export point). In the gold importing country money market rates would ease. This would eventually turn the exchanges in favour of the gold exporting country. Bills discounted on that market would fall, easing pressure on the gold centre. As long as confidence in the ultimate exchange parity was maintained, higher interest rates would make deposits more attractive and precipitate a capital inflow which would have an equilibrating effect. In this model higher domestic interest rates reduce domestic absorption and so increase exports tending to equilibrate the current account. Gold inflows, and a drop in bills discounted in that centre would strengthen the exchange and prevent any move to suspend specie payments. The deficiency of this model is that it applies more to the characteristics of the London market,[32] viz., the financial hegemon, and it also

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(1938). Hawtrey's research shows that UK bank rate was far more volatile than France's, with France resorting to various techniques to widen the gold points when needed. France of course did not operate on such an exiguous gold stock and its monetary system did not rely to such a large extent on credit which is inherently more volatile. Quoting Hawtrey (1978), "...financial crises are as unavoidable in credit systems as shipwrecks in navigation."p.206; and also Hayek (1966). As Drummond (1981) has pointed, it is often hard to see what advantage one derives from having a hegemonial currency. West Germany in the 1970s and 1980s was particularly keen to avoid a large off-shore market in its currency developing as it makes control of domestic monetary aggregates that much harder. Economic historians such as Pollard would probably concur with the view that a hegemonial currency is a mixed blessing, particularly in the UK case where it is often argued that the traded goods sector was sacrificed to sterling and City interests. Aldcroft argued, on the contrary, that it helped induce a more rapid resource shift away from the declining old manufacturing base towards the new industries and services which he argued were the source of renewed economic growth in the 1930s.

[30] see Ford (1960), cited in Bordo, "The Gold Standard the Traditional Approach," in, Bordo & Schwartz (1984) p.85.

[31] As we will see Dick & Floyd (1992) take issue with this assumption, arguing for risk adjusted interest rate parity.

[32] "Although the successful working of this sterling system - for that was really what the pre-1914 gold standard amounted to - did depend on the supreme international confidence in the pound, the particular institutional structure of international banking and finance which was centred on London, the acknowledged dominance of the Bank of England, nevertheless particular economic relationships played an important role in

suggests a mechanism whereby capital inflows would actually allow the authorities to forestall adjustment (cf., A.Walters ERM paradox[33] and Eichengreen Golden Fetters).

The textbook view of this model posits a symmetrical adjustment mechanism prompted by relative shifts in discount rates. This sort of symmetric adjustment mechanism is also found in Lindert's Keynesian trade induced income multiplier approach. However, most commentators have attributed a central role to London in the international monetary arena in part because of its net creditor position.[34] This is the essence of Ford's argument that the system was asymmetric in the sense that London could always draw balances through a rise in the discount rate at less cost than imposed on the periphery. Ford's argument is that the traditional view of the adjustment mechanism is an Atlantic one and ignores the impact on the so-called periphery. In Ford's model the periphery (in his model Argentina) is subject to a double shock. Higher interest rates in the centre reduce domestic demand and absorption, and hence periphery exports (and may give rise to a negative terms of trade effect), and deter capital outflows from the centre which might have acted as a cushion to accommodate the burden of adjustment/shock.[35]

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ensuring that, for Britain at least, maladjustments in the flows of international payments and receipts were never too large to swamp the institutional structure." Ford (1960), reproduced in, Eichengreen, The Gold Standard in Theory and History, p.161.

[33] The Alan Walters paradox is in fact a case of Gresham's Law. In this case the expectation of future convergence towards a fixed exchange rate prompts "bad money" (that enjoying higher interest rates resulting from a weaker fiscal situation and the need to control aggregate demand when domestic monetary tools have been abandoned to the exigencies of maintaining a fixed rate of exchange) to attract capital inflows and be the stronger of the currencies. So long, of course, as credibility is maintained. This is doubly perverse as the resulting capital inflows will offset any monetary tightening prompted by domestic demand conditions, i.e., sterilisation is ineffective. Hayek has pointed out that Gresham's Law operates as it does because of fixed ratios of exchange between currencies, whether they be commodity or other. However, if these ratios are allowed to fluctuate, viz., flexible exchange rates, Hayek argues that the stronger, least inflationary, currency will drive out the weaker. Gresham's Law can thereby be stood on its head and good money drive out the bad.

[34] Quoting Traynor (1949), "In the pre-war operations of the gold standard it was taken for granted that interest rates as determined by the central banks would respond to the inflow or to the outflow of gold. It does not seem to have been generally recognised, however, that the dominant position of the London money market was largely responsible for the apparently automatic operation of this system. London held more sight claims on other countries than other countries held on London. This gave England a leading position and obliged other nations to adjust their policies correspondingly. The system thus retained its stability through the pre-war period, without being tried by conditions of great stress. When the extraordinary strain of the war years proved excessive, gold was generally abandoned. This test was considered unique, however, and it was hoped that once the old system was restored it would not be so severely tried again." p.124.

[35] see Eichengreen, "The gold standard since Alec Ford," in, Broadberry & Crafts, 1992. However, Eichengreen's opinion is that, "...the "Ford hypothesis" that Latin American countries were buffeted simultaneously by capital -and commodity- market shocks seems to have been primarily a hypothesis applicable

Research by Triffin tends to demonstrate that interest rate and price movements far from being inversely correlated, as the classical price specie flow mechanism would suggest, were in fact positively correlated.[36] This is consistent with the view that London played a leading role in the international monetary arena, but also with the McCloskey & Zecher (1984) thesis, as well as Dick & Floyd's portfolio balance model which assumes risk adjusted interest rate parity *vide infra*. However, some studies have indicated that interest differentials did not narrow, which would leave the "real" adjustment mechanism unexplained.

Triffin's explanation for the positive correlation of interest rates is premised on the central role played by the Bank of England in the international monetary transmission mechanism. In this model the Bank of England is assumed to exercise a pre-eminent role in world trade finance, a role which is reinforced by its net creditor position. The positive correlation of interest rates is explained by the ripple like spread which a tightening of policy on the part of the Bank of England had on peripheral financial markets. As interest rates rose in London so the number of bills drawn on London would drop, easing the strain on the market, London would begin to attract funds as the demand for bills drawn on London which now yielded a higher rate of return increased, and funds would be remitted to London for deposit, i.e., the supply of bills drawn on London would drop, whilst the demand would rise. Policy tightening in London would then be followed by a hardening of rates in peripheral centres.

However, as a result of the war the UK lost its status as a net creditor. This had

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to Argentina, logically enough since that was the country studied by Ford." (op.cit., p.59).

[36] The Hume/Ricardo gold standard model, and particularly Hume's model (see his essay on "Money", 1752) which smacks of monetary hydraulics, suggests that interest rates movements would be negatively correlated as countries adjusted to payments imbalances, however Triffin demonstrated that interest rate movements were positively correlated. This is because the London money, accepting, and loan markets acted as the international transmission mechanism sending ripple effects through the world credit markets. Increased world demand for credit would translate in an increasing scarcity of bills on London and higher interest rates even before sterling reached its gold import point this would attract capital relieving pressure on the capital account of the UK balance of payments tighter credit conditions would feed through into foreign markets, particularly if gold had been exported, even before this happened, though, appreciation of sterling on the exchange towards gold import point would force authorities to raise rates in tandem with London. Thus monetary conditions would gradually tighten on the lead of London. In this model capital market integration and interest rate parity adjustment are accepted in line with the Dick & Floyd (1992) hypothesis. However, arbitrage in Triffin's model is considered as a process and not as being instantaneous. The difference with Dick & Floyd is that Triffin assumes that the UK thereby controls the level of world nominal interest rates and thus short-term real rates.

been considered one of the essential characteristics explaining the leading role which London played in the pre-war international financial arena.

Morgan (1952) was of the opinion that, "There is no doubt that London's net creditor position was wiped out by the war and we were left substantially in debt to some countries on short-term account and, quite, possibly, with an over-all short-term debit balance. This was the most important single weakness in the new position of London as an international financial centre, though there were others in the decline of the current account credit balance, the growth of the deficit with North America and the decline in the attractiveness of London to foreign depositors. Only the difficulties of subsequent years were to reveal how great a change these things had made in the conditions necessary for the smooth working of the international gold standard."[37]

Eichengreen also refers to the "Triffin effect" according to which a rise in London's discount rate would lead to a fall in commodity prices by increasing their carrying costs and so turn the terms of trade in Britain's favour.[38] The "Triffin effect" should more properly be attributed to Hawtrey who argued that the effect of a change of bank rate was to increase the cost of carrying stocks and that this had a stabilising effect on the balance of trade. This conforms to the asymmetric burden of adjustment, between centre and periphery, identified by Ford. Though Hawtrey's variant does suggest that the terms of trade would turn in favour of the periphery.

Goodhart[39] has argued that real factors underlay changes in money market conditions, as opposed to purely monetary phenomena.[40] He explains the conditions on the London money market as a case of reverse causation.[41] According to this explanation, if UK domestic trade was buoyant clearing bank reserves would fall as a proportion of assets, and as money market conditions tightened banks would be drawn to the Bank of England's discount window. Bank rate would be raised, this increase in rates would be transmitted to other money market centres. Though he questions the direction of causation he does not

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[37] Morgan (1952) p.379.

[38] see Golden Fetters,p.48, footnote 60.

[39] Quoted in Bordo (1984).

[40] see Goodhart, "The business of Banking 1891-1914," quoted in Drummond (1987) p.22.

[41] see Kaldor (1982).

dispute the leading role played by the London money market.[42] Eichengreen also stresses the importance of banks expanding or contracting domestic credit depending on the level of reserves (see P.B.Whale).[43] Eichengreen points out that this was known as the "credit-exchange standard" in New Zealand, with balances held in London playing the role of domestic bank reserves. This system also applied to Australia. As we will see throughout his analysis Eichengreen puts emphasis on the impact of capital flows on domestic credit, via the banking system, and thereby on domestic absorption. In the case of Canada balances were predominantly held in New York.[44]

However, Nurkse (1944) argued, that during the inter-war years "speculative" and cumulative destabilising capital flows could develop. The inter-war financial press and literature is replete with references to "hot money" flows. And capital flows would become destabilising.[45] Recognising this does not in itself constitute an indictment of capital flows, as was enshrined in the Bretton Woods system, but rather attention should be drawn to the underlying policies which prompted such shifts in assessment of currency risk by the financial markets.

With regard to the pre-war gold standard one should note that the authorities would often use devices to prevent their currencies reaching their gold points.[46] These measures included: interest free loans to gold importers, effectively narrowing the gold import point; paying out gold at the Bank of France, in Paris only, and in used coin. The Bank of France might also charge a premium on gold deliveries on the grounds that it was legally entitled

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[42] As we will see this is close to the Dick & Floyd interpretation and explanation for accommodating gold flows.

[43] see also P.B.Whale, cited in Golden Fetters, p.62.

[44] see Dick & Floyd (1992).

[45] see Kindleberger below; and Eichengreen, Golden Fetters.

[46] T.A. Clark (1984) has conducted a comparative analysis between gold arbitrage opportunities and actual gold movements in the period 1890-1908 and ascribes the failure of gold movements to always reflect opportunities for profit to government intervention. Methods which he identifies are, raising the gold export point by paying out used coin or charging a premium on bar gold, lowering the import point by offering free loans during the time of gold transit (typically ten days), or organising syndicates to manage the points, e.g., the sale in the US of drafts on London, thereby easing the demand for sterling. He concludes that in the short-run central banks could exercise discretion and that it is therefore necessary that the gold standard be accompanied by a system of rules. Clark argues that, during the period covered by his study, governments did act to prevent gold exports by tampering with the gold points.

to deliver silver. Thus, France maintained a steady discount rate.[47] In addition French gold ingots were not of the same fineness as those purchased by the Bank of England. This widened the gold points by the additional refining and assaying charges and the Bank of France maintained a substantial reserve which provided a cushion which would allow the authorities to insulate the domestic credit market from pressure coming across the exchanges,[48] the equivalent of intervention in today's parlance. In fact it could be said that the credibility of the gold exchange standard rested on this special quality, viz., that the commitment to redeem notes for gold represented an automatic intervention mechanism on the exchanges.

The failure to play the "rules of the game" tends to be substantiated by Bloomfield (1959). Bloomfield uses Nurkse's definition of the "rules of the game", viz., "...that adherence to the rules would involve concurrent changes in the same direction in the international and domestic assets of central banks," i.e., gold inflows would be mirrored by an increase in, "...central bank holdings of domestic income-earning assets"..."In this way, the effect of changes in central bank reserve holdings on the domestic credit base would be *magnified* by central bank action." However, for the period 1880-1913 Bloomfield found that, "In the case of *every* central bank the year-to-year changes in international and domestic assets were more often in the *opposite* direction than in the same direction, and in most cases *much* more often in the opposite direction."[49] Eichengreen has recently argued that the notion of "rules of the game" is misplaced and that the pre-war gold standard was characterised by a greater degree of discretion than often implied.[50]

The Bank of England was less prone to using these gold devices than the Bank of France. It maintained a free trade policy and a free gold market. The UK was the world's

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[47] see Hawtrey, A Century of Bank Rate.

[48] see Eichengreen Golden Fetters.

[49] Bloomfield (1959) pp.49-51. However, Eichengreen has argued that, "...When the comparison is limited to the two periods of fixed rates (1880-1913 and 1927-31), it is clear that violations of the rules were not equally prevalent before 1913."in, Suzuki, Miyake, & Okabe, (1990).

[50] see Golden Fetters, p.36.

gold centre and her capital market was much more open than that of other financial centres.[51] Much of world trade was financed through commercial bills which were drawn, accepted and discounted in the "liquid" and sophisticated British money market, many of the world's financial centres held balances arising out of international transactions for settlements purposes in London.[52] It was also easier to obtain forward cover, though the credibility of sterling reduced the need giving it an additional advantage. In this model, which gained increasing currency during the inter-war years, London acted as the fulcrum of the pre-1914 international monetary regime.

This putative central role played by sterling has been criticised on the grounds that it caused international factors to put undue pressure and demands on the British money and capital market which had to endure more volatile interest rates than say France and that this affected domestic economic activity.[53] According to this thesis the policy of maintaining an open capital market led to a capital outflow/drain which should have been invested at home. Morgan criticised the Bank of England for operating on too exiguous a gold base which, according to Morgan, accounted for the greater volatility of UK discount rates to the detriment of internal trade. Morgan attributed the low level of Bank of England gold reserves to a desire to increase profitable discounts, suggesting a conflict of interests between its role as a nominally private bank and central bank.

However, it must be borne in mind that return on previous investments, and invisibles helped close Britain's traditional deficit on trade account. This policy also helped open and

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[51] see Feis (1974); Platt (1968); and Edwards (1987). Einzig (International Gold Movements) has pointed out that London maintained the only free gold market. In New York and Paris transactions were carried out by the central bank. Holland and Denmark only allowed gold exports to countries offering reciprocal arrangements.

[52] Quoting Scammell (1985), "Overseas banks in many countries held working balances of sterling, either in the form of London acceptances, loans to the London discount market or London bank deposits, and were prepared to use these balances for residual clearing. Moreover, in some countries, central banks held part or all of their main reserve in sterling, preferring sterling to gold, partly for the interest which the sterling assets yielded and partly because the bulk of their trade lay with the United Kingdom and sterling balances were a trading convenience. Thus the picture of gold standard operation in the period before 1914, is one of a close interchangeability of gold and sterling which gave to the Bank of England not only the role of regulator of the British monetary system but, in great part, that of regulator of the gold standard and the international payments system." p.104.

[53] see Hawtrey (1938). However, if one accepts capital market integration lower French interest rates could only be achieved by means of capital controls or a managed standard which implies a degree of credit rationing. The use of "moral suasion" in the UK did in fact constitute a form of credit rationing.

develop markets which would contribute to enlarge world markets to the benefit of Great Britain.[54] There was an intrinsic link between Britain's role as a major trading nation and her financial and erstwhile maritime supremacy.[55] For as so much trade was invoiced and financed through London, working balances had to be held in London, this further enhanced its financial role as these balances would be invested in short term paper adding to the market's liquidity and depth, thus, reducing the costs of sterling transactions. Dick & Floyd (1992) point out that the product of a foreign capital issue would only gradually be drawn down and be held in UK short term money market instruments, thus enhancing liquidity and smoothing the strain on the balance of payments.

Lindert (1969) has stressed the international status of currencies other than sterling, particularly the French franc and German mark.[56] Large balances were held in French francs and also marks. A significant proportion of Russian balances were held in French francs, though neither currency had the international radius of sterling. France was a very significant source of capital before the First World War, due to its high domestic savings rate which was probably in part due to its less sophisticated financial market and historical

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[54] Jones argued that the UK was not altruistically providing the key international currency as an international public good, but that this conformed with its own interests, "The Bank of England adopted a more or less neutral attitude in the sense that it performed the essential functions of an International Bank and regarded the problem of monetary stability as an international problem. I do not, of course, suggest that its attitude was altruistic and that Great Britain voluntarily adopted such an attitude merely in the interests of world stability and progress. Such was not the case. The economic structure of Great Britain and the position that she held as the largest investing country and the centre of world finance made her individual interests identical with the interests of the world as a whole. There was no conflict, or presumed conflict, between the one and the many." Quoted in The Future of Monetary Policy, R.I.I.A., p.126, from Prof. J.H.Jones, "The Gold Standard," E.J. (1933) pp.564-5.

[55] "A large part of British wealth has been derived in the past from the export trade, facilitated by the activities of the City of London as the greatest financial centre of the world. A halt has been called to the expansion of export trade, and the position of the "City" is rendered more difficult by the general financial confusion of the post-war world." Unemployment an International Problem, R.I.I.A., (1935) p.440.

[56] see also D.Calleo in, Rowland (1976), ed., Balance of Power or Hegemony. Calleo rejects the hegemonial thesis and prefers a balance of power or more multilateral/pluralist analysis of the pre-war gold standard. Quoting Calleo, "The French had an imperial bloc, which extended to Russia, whose large borrowings from Paris were kept in great part, as franc balances in French banks. The Germans, in a similar fashion, sought to extend their monetary bloc throughout Eastern Europe. In short, the gold standard system was composed of a number of currency blocs, within each of which a particular reserve currency held sway. The network among these blocs constituted the world system. While the principal members were interdependent to some degree, Britain's position among them was far from comparable to the monetary hegemony exercised by the United States in the 1960s. While sterling was the most important vehicle currency used for trading purposes, and was, as we have stressed, the reserve currency within the formal and informal empire, its use as a reserve among the major centers is much more doubtful."(op.cit., p.240).

distrust of credit institutions rooted in the collective memory of the bankruptcy of John Law's bank and the hyper-inflation of the French revolution. Eichengreen concurs with Lindert's emphasis on the importance of other financial centres,[57] namely Paris and Berlin, arguing that the pre-war gold standard was characterized by a greater degree of multipolarity than was recognised and that the Bank of England rather than being the lender of last resort to the international monetary system could more properly described as the "borrower of last resort."[58] In fact Eichengreen argues that international co-operation saved sterling in the crises of 1890, 1906, and 1907.[59]

Kindleberger argues that Britain's averred central role in the pre-war international monetary system had been stabilising as it lent contra-cyclically and so helped steady the international business cycle,- the so-called financial hegemon thesis. His thesis rests on the need for a vehicle currency to act as an N-1 international *numéraire* and whose central bank would provide liquidity to the international financial system and act as its lender of last resort. According to Kindleberger the post-war system was unstable because of the emergence of two other rival financial centres, New York, in particular, but also Paris. Kindleberger blames the lack of co-operation between these centres, with the exception of 1924 and 1927, for precipitating destabilising capital flows between centres. Others have shared this view stressing the importance of London at the centre of the pre-war international monetary regime and the co-operative relations which had characterised that period.

This was the view taken by Scammell (1985), "Such central bank co-operation was very real, involving all the participant countries in some surrender of national sovereignty - a surrender partly to the objective gold standard rules of the game and partly to the discretionary authority of the London money market and the Bank of England, who virtually managed the gold supply. Although it is customary to regard the nineteenth-century gold standard as an automatic system without formal organisation or specified modes of operation, it is, in the writer's view, arguable that the gold standard was in fact quasi-organizational, being operated by a team of central bankers co-operating under the leadership of the Bank

[57] see Golden Fetters, p.391.

[58] see Golden Fetters, p.30.

[59] see Golden Fetters, p.51.

of England on behalf of the world business community."[60] Eichengreen (Golden Fetters) shares this opinion.

It has been argued that the restored post-war gold standard was out of kilter,[61] it represented an effort to arrive at some form of equilibrium, whilst the pre-war system represented an organic relationship which had been established over the years, "The War had a profound effect upon this international monetary system. The pre-War and post-War gold standards had certain technical differences -discussed below- but overshadowing all these is one vital distinction of general economic significance: the pre-War gold standard was the result of an increasing international relationship between prices and costs; the post-War standard was set up in the hope that it might restore such a relationship. The former was organic, the latter synthetic. The one was the result of a de facto specialisation of productive resources; the other was intended to restore and foster the further development of internationally advantageous specialisation with which war-time and post-war influences had seriously interfered."[62]

Lindert (1969) developed a Keynesian model to explain the adjustment mechanism under the gold standard using trade derived income effects (along Ohlin lines - see Triffin).[63] Increased exports would have domestic income multiplier effects which would increase domestic absorption, reduce the trade surplus, the converse would occur in the country losing specie. This would put a check to any current account imbalance and promote

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[60] see Scammell (1985) p.105. Morgan (1965) pointed out that the Bank of England relied on at least the tacit co-operation of other central banks which would refrain from competitively raising discount rates and connections in the City, e.g., moral suasion. On the question of banking policy under the gold standard Morgan would remark, "About all this there was nothing automatic, no simple and obvious rule by which all decisions could be tried." see pp.224-227.

[61] see R.I.I.A. (1935).

[62] see R.I.I.A. (1935) The Future of Monetary Policy p.124. Scammell (1985) contrasted the pre- and post-war financial regimes which emerged in the following terms, "The restored gold standard of the 1930s has no institutional framework and was diversely operated, mainly by national governments and politicians, for national ends: the old gold standard had been operated by monetary technicians, according to widely accepted technical criteria." p.105.

[63] It is interesting to note that in fact Keynes was neo-classical on the transfer issue, arguing in terms of changes in relative prices, whilst Ohlin's analysis rested on income multipliers and domestic absorption. In that sense it was Ohlin who was "Keynesian."(see Flanders, 1989, pp.240; 242; 254; 285). One should note that the Keynesian absorption model and the monetary approach to the balance of payments share certain affinities in that they both lay emphasis on domestic absorption rather than relative price movements as in the Hume/Ricardo price-specie-flow mechanism.

an eventual return to equilibrium.

In the following section we will explore what we have dubbed the third strand of thought on the functioning of the gold standard which is more classical in its roots. As a counter-point we will analyze the more political, Marxian, critique of this type of model and of the sterling standard interpretation.

McCloskey & Zecher (1984) have developed a model which identifies the adjustment mechanism as dependent on the demand for real cash balances. That is to say the national money supply is endogenous, as opposed to the Friedman & Schwartz model which assumes that the domestic money supply can be controlled, i.e., is exogenous. In the McCloskey model only the world money supply is exogenously given and this determines the nominal level of world prices. This analytical model is actually rather close to that adumbrated by Hawtrey to explain the substantial French foreign exchange and gold imports during the period 1928-32 (the so-called "gold avalanche"). According to this model, as trade and productivity increase, demand for real balances rises, this translates into a current account surplus (substitution of money for goods), the resultant import of gold will raise the domestic money supply satisfying the demand for real balances.

Dick & Floyd (1992) have developed a rather similar model, though it stresses the importance of capital flows (which they argue have been neglected in the traditional models, viz., Hume; the monetary approach; and McCloskey & Zecher). In their model capital flows accommodate the demand for cash balances with trade flows playing a purely accommodating role. Capital flows are the dominant feature and are dependent on the demand side on real factors, viz., investment opportunities, demographics, etc., and on the supply side on the level of savings. The savings/investment gap is then filled by way of capital flows.[64] In this model risk adjusted interest parity obtains and goods arbitrage ensures that the law of one price holds, though not in the non-traded goods sector. As a result real exchange rates may diverge, whilst in the McCloskey & Zecher model this is not the case as arbitrage between the traded and non-traded goods sector is said to obtain.[65]

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[64] Quoting Dick & Floyd (1992), "The essential basis for capital flows in a properly formulated model is that the equilibrium allocation of world investment among countries is different from the allocation of world savings." p.15.

[65] Dick & Floyd (1992) take issue with the extreme arbitrage assumptions of the McCloskey & Zecher model, "The law of one price holds in the model developed here as it does in any properly formulated one, but it implies one price for each commodity in each market not one price level throughout the world." (Dick &

McCloskey & Zecher reject the classical price specie flow mechanism on the grounds that it infringes the law of one price, viz., international price arbitrage. They also assume domestic arbitrage between traded and non-traded goods, thus real world prices are integrated.[66] Any departures from purchasing power parity can only be due to temporary imperfections, and real exchange rate parity should also obtain given their assumption about arbitrage between traded and non-traded goods. Though their model is more subtle it does assume a degree of homogeneity amongst goods, arbitrage conditions, and a degree of market clearing which often are belied by experience. It also leaves unanswered the question of how economic agents are able to distinguish real from nominal price movements (*ex ante*),- if that condition fails money can have real effects.

One should note that price movements even when anticipated can have real effects if contracts are backward looking and do not incorporate indexation clauses to take into account monetary shocks. Taking a balance sheet approach to money and other assets (viz., a classical Pigouvian, or "inside" money, view) might suggest no net wealth effects, but this would be contrary to our dynamic view of credit, expectations and the cycle, and the notion that relative distributional effects are not neutral in their impact on economic activity.[67] One should note that their model does not explain how the absolute level of world nominal prices is determined, i.e., the world money supply. In a gold commodity standard world this can be explained by the hazards of gold discoveries and mining technologies, but in a

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Floyd, p.170). Their disagreement on this question is intrinsic to their model which assumes that real factors drive domestic demand (e.g., opening up of the Canadian West) this is reflected in a rise in non-traded goods prices, an increase in demand for cash balances, and capital inflow. The demand for domestic credit reduces the capital to assets ratio of domestic banks which then drawn down balances held in New York and acquire gold to increase their reserves, thus gold flows are purely accommodating. The capital inflow is financed by the ensuing increase in domestic absorption which translates in a current account deficit. One should note that in the classical price-specie-flow mechanism the current account and gold flows are inversely correlated, whilst in the Dick & Floyd (1992) model a deteriorating current account position (and appreciating real exchange rate) are accompanied by a capital/gold inflow.

[66] However, in a present day context given the very substantial role of transfer payments, etc., and various non-traded merit goods delivered by the state which account for significant proportions of national income it is difficult to fully accept McCloskey & Zecher's demanding assumptions. Particularly if wage pressure is driven by the non-traded goods sector, e.g., in Italy and the leading role taken by public sector wages settlements (the obverse of the Scandinavian price-taker model). In this instance distortion takes place in the form of the public sector deficit.

[67] Quoting Keynes (1923), "Deflation as we have already seen, involves a transference of wealth from the rest of the community to the *rentier* class and to all holders of titles to money; just as inflation involves the opposite. In particular it involves the transference from all borrowers, that is to say from traders, manufacturers, and farmers to lenders, from the active to the inactive."p.143.

financial environment increasingly characterised by credit, *monnaie scripturale*, the question becomes more difficult.

Triffin argued (see below) that the so-called international gold standard period marked the euthanasia of commodity money against the increased prevalence of credit money. De Cecco (1984) has rather cogently argued that the development of credit money/*monnaie scripturale* constitutes a form of financial disintermediation resulting from the restrictions imposed upon central banks' credit policy as a result of the spread of the "currency principles" of Peel's Act of 1844 regulating the activities of the issue department of the Bank of England. This mandated 100% backed money, at the margin, above a fixed fiduciary issue. In this case the development of commercial banking constitutes but another instance of "Goodhart's law."[68]

The McCloskey & Zecher model taken at face value suggests that it makes no difference whether exchange rates are fixed or not (because the authorities can only influence nominal exchange rates) arbitrage should ensure rapid equilibrium in financial and goods markets. However, currency experience in the 1980s demonstrates that there could be long periods during which currencies could over and under shoot so-called "equilibrium" rates.[69] Taking an extreme view of their model central bank policy becomes irrelevant outside the very short-run. This model also treats money as a veil and implicitly assumes monetary neutrality. It also ignores the very real adjustment costs to new equilibria which is the essence of our thesis and Eichengreen's latest work.[70]

Nevertheless, even if one accepts their model it does not invalidate the proposition of a deflationary monetary and fiscal disequilibrium path resulting from a process of

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[68] Though one should not discount the importance of such regulatory factors as the introduction of joint-stock banking, previously the capital base of banks had been limited by the requirement that they be confined to a maximum partnership of six individuals with unlimited liability.

[69] Though the concept of equilibrium exchange rates is fraught with difficulties and there are no objective criteria to suggest that these should be other than that prevailing in the market. The Dick & Floyd savings/investment gap model suggests that an attempt to define an equilibrium exchange rate according to some measure of purchasing-power-parity would not only be meaningless, as this could indicate no more than the rate of inter-temporal absorption (whether determined by government in which case it could be argued that it was distortionary, or by the private sector in which case one is led to believe that it would be self-financing,- this belief guided British macro-economic policy from the mid-1980s until 1989 with the unfortunate results that have become so apparent); but, be destabilising too, e.g., if "remedial" action were taken to increase absorption in the country enjoying a surplus this could cause severe distortions in that economy, e.g., the Japanese asset bubble from the mid-1980s to the end of the decade.

[70] see Golden Fetters.

adjustment to "mis-aligned" exchange rates. In this context none of the following propositions are invalidated by the McCloskey & Zecher thesis: the deflationary impact of a scramble for cash balances at a world level to adjust real balances to the inflated price levels in the immediate post-war world (see Hawtrey and the recommendations of the Genoa conference); the debt deflation that this path would impose (see Irving Fisher); the effect on world liquidity that the increased accumulation of world base money, viz., gold, in the Federal Reserve Bank of New York and later Paris would have (i.e., gold maldistribution);[71] and the effects of failure to recycle this surplus or to allow it to act on domestic liquidity. According to this interpretation (q.v. Hawtrey in particular) failure to allow gold inflows to have a significant impact on the domestic monetary base of the gold importing country would tend to precipitate additional inflows further sterilising liquidity.[72]

The McCloskey & Zecher model interpreted in this disequilibrium guise implicitly traces an interpretation of the causes of the depression which is consonant with Hawtrey's analysis.

One should note Eichengreen's point that so long as gold sterilisation of inflows continued so did its cause,[73] and this was particularly unsettling for deficit countries as they would eventually have to adjust. This is not to deny the necessity for a real transfer to take place, either at once or smoothed inter-temporally by borrowing or in the short-term by reserve sales, rather it rests on the contention that adjustment would prove smoother if the surplus countries were to expand credit rather than sterilise base money and subject the deficit country to a double shock of having to deflate the nominal money supply and effect

[71] With regard to the behaviour of the Fed., in the early 1920s, Keynes (1923) argued that, "The theory on which the Federal Reserve Board is supposed to govern its discount policy, by reference to the influx and efflux of gold and the proportion of gold to liabilities, is as dead as mutton." (p.198). He would add, "In fact it has established a dollar standard; and, instead of ensuring that the value of the dollar shall conform to that of gold, it makes provision, at great expense, that the value of gold shall conform to that of the dollar." (ibid., p.198). The fluctuations in the purchasing power of gold worried British policy-makers (cf., Strakosch, in, Gayer, 1937); hence, the British call at Genoa for a follow-on conference of central banks to discuss the issue. It was not until 1932 that the Gold Delegation reported to the League of Nations. The need for political consensus in the main body of the report prompted the issue of a dissentient note by, arguably, the delegation's most prestigious members.

[72] see chapter ten of this thesis.

[73] see Golden Fetters, p.207.

the transfer.[74]

The McCloskey-Zecher model which in its own way would tend to conform most closely to the classical model of a gold standard characterised by automaticity,- as opposed to the view which became increasingly prevalent in the inter-war years that the gold standard had owed much of its specificity to the central role played by sterling (see Cassel[75] and more recently Kindleberger),- can still account for deflation spreading in part as a result of the maldistribution and insufficiency of gold given the post-war price level, the path towards a new lower nominal world price level being traced by a desire to reconstitute cash balances and reserves. However, according to McCloskey & Zecher's model one would assume that in an environment characterised by falling economic activity the demand for real cash balances would drop, goods' prices would rise, avoiding a deflationary cycle. In practice this did not occur and cash balances become increasingly attractive compared to other assets,[76] particularly when nominal interest rates have reached a floor (set by the additional

[74] It follows from our emphasis on the disequilibrium nature of a deflationary adjustment path that this would lead to a lower level of "equilibrium" output and that even if supply-side rigidities were inexistent the fact that deflation is not distributionally neutral in its wealth effects, favouring the passive *rentier* class against the active sector as it used to be expressed, it is our opinion that it would not be costless. However, for a decidedly contrary opinion see Hayek (1937; Lectures III & IV). Hayek's book is well worth disinterring as it presents an early exposition of global monetarism and an insight into the phenomenon which later became known as stag-flation in the 1970s.

[75] "Professor Cassel points out that even for some time before the war the gold standard had ceased to function automatically, owing to the large and increasing international capital movements which vitiated the reciprocal influence of price levels, trade balances, and exchange rates. That the gold standard worked fairly well, in spite of this, is due to the fact that before the war the whole civilised world constituted a huge sterling bloc." From an article referring to Cassel's latest book in, Financial News, 20/4/36.

[76] This analysis is shared by Meltzer (1976) who argues that during the US monetary contraction of the 1930s deflation caused a rise in the return on real balances and short-dated securities, raising the price level would have lowered the real rate of return and, "If the real return to real balances and Treasury notes had been reduced, spending would have increased."(p.469). In France it was feared that such a policy would lead to an increase in the note circulation and only fuel currency flight and lead to gold reserve losses. Hamilton (1992) has taken issue with the notion that high real interest rates might have been an initiating factor (in a US context), arguing that as futures prices were ahead of spot prices deflation was not anticipated. And that the fall in the nominal yield on Treasury bills was therefore, *ex ante*, taken to be a fall in real yields. However, this could be expected to have an effect on investment activity. Hamilton concludes that as commodity markets did not anticipate deflation, *ex ante* interest rates were not high. He adds that the unanticipated decline in prices was not enough to explain the downturn and banking collapse. He emphasises the importance of relative price effects, though recognising that expected deflation did set in and could explain behaviour in the second and third years of the depression (p.172). Cecchetti (1992), though, has argued that futures prices are not an accurate proxy for price expectations as the government used it as a medium to prop up commodity prices. Cecchetti tries to demonstrate that deflation was anticipated, raising real *ex ante* interest rates, thereby reducing investment. Stock market behaviour would however conspire to belie such an interpretation (see Galbraith, 1955), rather one should emphasise the sharp shock and alteration to the expectational environment. The

convenience and liquidity which cash balances offer over other instruments) and prices are falling. This may precipitate a deflationary cycle as "involuntary" real cash balances rise making, in turn, these balances more attractive to hold, as the price level drops, i.e., liquidity preference would prove stronger than any putative equilibrating Pigou effects.

However, nominal wage inflexibility in the inter-war period and increased government responsibility for domestic economic conditions, as opposed to the 19th century concern for the state of trade, made it more difficult to pursue deflationary policies and politicized,[77] and reflected the politicization of, the economic and monetary policy debate.[78] Eichengreen also points out that before the First World War governments eschewed confiscatory taxation and did not question the gold standard.[79]

By the late 1920s Hawtrey was arguing that it was necessary to raise the price of commodities. Roosevelt alighted on the trick of steadily increasing the dollar purchase price of gold (thereby wrecking any chances of reaching a currency agreement at the London World Economic Conference). Currency depreciation would tend to restore the equilibrium between wholesale and retail prices which, Hawtrey, and Reynaud in France, argued, was one of the prime causes of the depression. The attempt to drive down retail prices, one of the main components of which were relatively fix nominal wages, to an equilibrium level with wholesale prices, which constituted one of the main objectives of deflation, was abandoned in favour of raising commodity prices. This would be achieved by reducing the purchasing power of the dollar in terms of commodities.

Hicks' distinction between fix and flex prices is useful to understand the perverse nature of deflationary policy which aimed at reducing fix prices (deflating nominal variables to effect a real change in prices and wages) to bring them into line with flex prices (wholesale and commodity prices). Hawtrey came to realise that it would be less costly to raise flex prices in line with fix prices and thereby avoid the far higher and destabilising

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emphasis that we place on the return to cash balances, reduction in credit multiplier, etc., is not as an initiating factor in the depression, but as a contributor to the "credit deadlock", to quote Hawtrey.

[77] In France deflationary policies would be rejected at the polls in 1936, with the electoral victory of the Popular Front. In the UK once the virtues of a managed exchange rate were understood Neville Chamberlain would refuse to enter into any exchange rate commitments.

[78] see Eichengreen, Golden Fetters.

[79] Golden Fetters, p.39.

adjustment costs associated with the deflationary strategy, i.e., inflation is a less costly adjustment mechanism than deflation,- within bounds.[80]

McCloskey & Zecher attribute the steep rise in the dollar price of commodities during 1933-34 to Roosevelt's policy of dollar depreciation, implying that the US was a price-taker. They cite this as a clear-cut case of international arbitrage and the law of one price.[81] Friedman & Schwartz lay greater emphasis on the relaxation of US monetary policy.

As we have noted a recent addition to the literature is Dick & Floyd's Canada and the Gold Standard (1992). This work constitutes a critique of J.Viner's work, Canada's Balance of International Indebtedness 1900-1913. Viner attempted to demonstrate that when due account was taken of the intrinsic link between Canada and the New York money market, it could be shown that the behaviour of the Canadian balance of payments did conform to the classical price-specie-flow mechanism. Dick & Floyd argue that the lags that one would expect to see between gold flows, prices, and trade deficit are not apparent.

Their thesis therefore aims at explaining the adjustment mechanism in a period characterised by large capital inflows associated with the development of the Canadian West. To the traditional models,- viz., elasticities, characterised by relative price movements; and the monetary theory of the balance of payments/absorption approach; in both of which adjustment takes effect through the goods market, either by way of arbitrage between goods (Hume/Ricardo price-specie-flow), or by way of substitution between money and goods (monetary approach); and the Keynesian income elasticities approach,- they oppose their portfolio balance approach.[82]

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[80] Quoting Hawtrey, "In the past monetary theorists have been disposed to lay stress on the dangers of inflation. That those dangers are real and that warnings on the subject are necessary was shown only too clearly by the events of the years 1914-1923. But the experience of the past seven years has shown that the dangers of deflation are even greater."p.144, from, "The credit deadlock," in, Gayer ed., (1937). Keynes (1923) shared this view, "Of the two perhaps Deflation is, if we rule out exaggerated inflations such as that of Germany, the worse; because it is worse, in our impoverished world, to provoke unemployment than to disappoint the *rentier*." p.40.

[81] see McCloskey & Zecher (1984).

[82] Quoting Dick & Floyd (1992), "In the present analysis, balance-of-payments equilibrium is established by a direct exchange of money and nonmonetary assets, whereas in the analysis that ignores international capital flows, disequilibria in the balance of payments lead to money flows financed only by adjustments of the trade balance."p.169. So that in their model gold movements are part of stock portfolio adjustment. They argue that only if one totally excludes capital flows are, "The elasticities, absorption and monetary approaches to the balance-of-payments adjustment...only equivalent if the balance of payments and the balance of trade are one and the same thing."p.157. They attribute the failure to focus on capital flows to the fact the price-specie-flow

They argue that the crucial originality of their model rests on the introduction of international capital mobility.[83] Arbitrage in the goods market ensures that the law of one price holds in the traded goods sector (but not in the non-traded goods sector), whilst capital market integration ensures that risk adjusted interest rate parity holds. And therefore, "There is no causal relationship between international capital flows and domestic/foreign interest-rate differentials."[84]

But what do relative interest rate differentials express other than the objectification of different subjective risk appreciation and different liquidity and transactions costs? As a further critique one should add that equilibrium *ex ante* interest differentials are constantly arbitraged in the market by means of capital flows in a dynamic process.[85] Their thesis implies a resounding negation of the centrality of London as the fulcrum of the gold standard and the role of UK bank rate.[86]

They dichotomize in the classical tradition the real and monetary sectors. Equilibrium in the real sector being determined by relative scarcities and demand. Substitution in

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mechanism was developed in the 18th century when there was little distinction between the trade balance and the balance of payments. (op.cit., p.155).

[83] Quoting Dick & Floyd (1992), "...the essential difference between the portfolio adjustment and the traditional classical models lies in the treatment of capital mobility." p.128.

[84] Dick & Floyd (1992), p.140.

[85] The difference here lies in the snapshot "photographic" timeless analysis of a momentary state dubbed "equilibrium" and the dynamic "kaleidoscopic" (q.v. Shackle) study of economic phenomena through time. Frobert (1992) makes a plea for rediscovering F.Simiand's work in this field and particularly what he judges to be his useful critique of the treatment of time which characterized, and still does, most economic models. Simiand's work criticised the implicit reversibility of processes which one finds in these models. This has come very much to the fore in the economics profession with the ascendancy of the Lausanne school of Walras. It is interesting to note that both Walras and his successor, Pareto, were trained as engineers. Of course, the failure to treat time as process is to be found early in the profession (q.v., my reference to Hume's monetary hydraulics) and is characteristic of Ricardo's abstract reasoning. Frobert argues that Simiand was influenced by H.Bergson. There has always been a current in the economics profession which has laid emphasis on the need for a proper treatment of processes through time and uncertainty. Among these are: J.M.Keynes; F.Knight; D.H.Roberston; I.Kirzner; J.Hicks (on occasion); and the "Austrian school," particularly in their treatment of capital and time where they differ markedly from the classical, neo-classical, and new-classical macro-economists and supply-siders with whom they otherwise have much in common,- particularly ideologically. It is particularly important here to note the difference between the Mises/Hayek's treatment of the real distortionary effects of inflation and deflation against the relatively neutral hypothesis that one finds in classical models, e.g., Hume, Ricardo, Pigou and some of the latter day new classical macro-economists.

[86] Quoting Dick & Floyd (1992), "Our analysis casts serious doubt on whether the Bank of England could have orchestrated the international gold standard by manipulating its discount rate, as many scholars believe it did." p.171.

portfolios between money and assets, both domestic and foreign, which give rise to capital flows, being determined by relative demands for money.[87] These, however, are ultimately determined by real factors, viz., investment opportunities, demographics, etc.

Their model implies a direction of causation which is inverse to that expressed in the Hume model.[88] The latter leaves unexplained how the initiating rise in prices occurs within a commodity money model.[89] Quoting Dick & Floyd (1992), "Because of international capital mobility, the domestic money supply adjusts automatically to the demand for money. Balance of payments disequilibria and gold flows are the process by which this adjustment occurs. Domestic prices are determined by world prices and the relative valuation world markets place on domestic as compared to foreign goods. Gold flows occur because price and income changes affect the demand for money and operate to bring the supply of money into line with the demand. They do not occur because price and income changes affect the balance of trade."[90] It is the, "...general public which determines the money supply by its portfolio decisions," and they add, "There is no observed causation from gold to money to prices for good reason - the direction of causality runs the other way."[91]

In their model the money supply is endogenous and determined by private portfolio decisions.[92] The stock of money in turn determined the level of gold reserves as increased credit demand increased banks' ratio of assets to reserves, and in order to reconstitute these reserves banks drew down balances held in New York acquiring gold instead. This portfolio

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[87] Quoting Dick & Floyd (1992), "In the model presented above, perfect substitutability of domestic and foreign assets in portfolios implies a complete separation of monetary from real equilibrium. Balance-of-payments adjustments arise from monetary disequilibrium and have no impact on the real sector. In this respect our model accords well with the premises of McCloskey and Zecher and the other proponents of the monetary approach." p.29.

[88] Quoting Dick & Floyd (1992), "The first implication of the portfolio theory developed in this study is that Canadian prices cause Canadian money and not vice versa." p.89.

[89] Friedman & Schwartz have the same problem, as distinct from Hayek's monetary theory. In Friedman there is no role for interest rates or financial intermediaries. In effect his model treats money in a very classical fashion as though it were coin/specie. The difficulty in reconciling this with the present-day credit/money explains his resort to the helicopter metaphor as a *deus ex machina*.

[90] Dick & Floyd (1992), p.28.

[91] From Dick & Floyd (1992), p.120.

[92] Quoting Dick & Floyd (1992), "In the present context of fixed exchange rates and international capital mobility, however, the monetary base is not a useful concept. The money supply was endogenously determined as a result of private portfolio decisions." p.125.

reallocation might be mirrored by private individuals selling securities abroad against gold. Whilst in a downturn domestic agents would reduce excess money balances, purchasing foreign assets and gold inflows would fall off.[93]

They posit a correlation between the price of Canadian non-traded goods to other non-traded and traded goods. The rise in prices caused by real factors, initiates the capital inflow, to close the savings/investment gap, and finances an increase in the note circulation. Banks' reserves against deposits and notes had to be held in gold or Dominion notes, which in turn were backed by government gold reserves. Thus an expansion of domestic money and credit eventually leads to a gold inflow,[94] not the converse.[95]

In the standard classical model (price-specie-flow) in which capital flows are absent only the divergence between export and import prices can lead to gold flows. The mechanism being a rise in the money supply, a fall in domestic interest rates (capital being immobile interest parity does not hold), increased domestic absorption and prices, a deficit in the trade balance, followed by an outflow of gold. However, the introduction of capital market integration (substitutability between domestic and foreign assets) means that interest parity holds, intervention becomes ineffective, and the domestic money supply is endogenous. The money supply is detached from the goods market (as opposed to the specie flow model and the monetary approach) and depends on portfolio substitution between monetary and nonmonetary assets. However, the money sector and the goods market are integrated as the policy of setting a fixed gold purchase price indirectly determines the relative price of gold against goods and solves the N-1 problem and provides the link between the real and

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[93] Quoting Dick & Floyd (1992), "In the portfolio approach, the balance-of-payments surplus represents a portfolio adjustment - an international exchange of assets - that brings the demand for money into line with the supply. If domestic residents hold too little money, they sell assets abroad, forcing the domestic banking system to accumulate gold and foreign exchange. The total flow of capital between Canada and the rest of the world is unaffected - only its composition changes. The nonbank public sells nonmonetary assets abroad and the banking system accumulates an equivalent amount of foreign exchange reserves. The overall net capital inflow from abroad is the same, with a larger fraction of it now in the form of gold and liquid foreign reserve assets and a smaller fraction held in nonmonetary assets by the nonbank public. A balance-of-payments surplus or deficit is thus strictly a capital account phenomenon, involving no change in autonomous exports and imports. The fact that the balance of trade responds to relative price and income changes has no bearing on balance-of-payments equilibrium." p.162; see also p.152.

[94] see Dick & Floyd (1992), pp.27-28.

[95] Quoting Dick & Floyd (1992), "When capital markets are integrated, gold moves directly, without effects on relative domestic and foreign prices and the balance of trade. It is capital market integration, not purchasing power parity, the unity of goods markets, or arbitrage in goods, that produces this result."p.31.

monetary sectors.[96]

It is interesting to note how this model differs from the Hawtrey/McCloskey & Zecher exposition, the difference residing in the introduction of capital flows. In the former model, and the monetary approach, substitution occurs directly between money and goods without the intermediation of capital flows precipitated by a portfolio readjustment. And in contra-distinction with the price-specie-flow mechanism and Cassel's purchasing-power-parity thesis it is not through money flows that the law of one price is established,[97] but by means of international arbitrage in the goods market.[98] In the price-specie flow and some variants of the monetary approach models, particularly Friedman's exposition, it is the exogenously given money supply which drives the balance of payments to bring back equilibrium between the money and goods market,[99] whilst in the Dick & Floyd model it is the capital account driven by real factors which determines the domestic money supply (which is then endogenously given) and the current account responds as the mirror image of capital account

[96] Quoting Barro (1979), "Money and the price level under the gold standard," E.J., "Since the "central bank" supports the nominal price of a reserve commodity such as gold under these systems, the determination of the absolute price level amounts to the determination of the relative price of the reserve commodity. In this sense the absolute price level becomes a determinate quantity that is amenable to usual supply and demand analyses, as applied to such things as gold production and non-monetary uses of gold."p.13. This resolves the problem posed by the classical dichotomy, viz., the integration of monetary and value theory (q.v., D.Patinkin).

[97] Quoting Dick & Floyd (1992), "The standard price-specie-flow mechanism is an appropriate analytical framework only when capital does not move internationally in response to market forces. When capital is internationally mobile, world portfolio equilibrium is achieved by an international exchange of gold for assets or other assets for gold. No relative price adjustments and associated shifts in imports relative to exports are required."p.119.

[98] Quoting Dick & Floyd (1992), "Money determines domestic prices only through its effect on the world price level. Real factors determine the ratio of domestic to foreign prices."p.119; see also, p.31. In this model real factors will determine the real distribution of money and gold. This also applies to Ricardo's price-specie-flow mechanism in the long run, as he recognised. This analysis is shared by Hayek (1937) and the global monetarists (q.v., McKinnon).

[99] One should note that this is not the case in the McCloskey & Zecher monetary model where money is endogenously given and the law of one price obtains. The current account of the balance of payments serves to bring equilibrium between the supply and demand for money. The direction of causation is strictly reversed. This difference in analysis between the monetary nationalists, viz., Friedman & Schwartz, and McCloskey & Zecher is well captured in the following exchange, "After 1934, both inflows and outflows of gold were not permitted to affect monetary growth and the performance of the economy."(Schwartz, in, Campbell & Dougan, 1986, p.62). "I would read these numbers just the other way around to say the Federal Reserve was increasing and decreasing domestic credit for a variety of reasons, and the balance of payments was operating like a shock absorber, as it had in the original period, to offset the shocks and bring domestic money supply into balance with money demand."(Zecher, in, Campbell & Dougan, 1986, p.83).

flows, thus financing it.[100]

It may be that their thesis conforms more closely to the specific characteristics of the Canadian economy in terms both of the new frontier opening in the West and its very close financial links with both London and New York. One may question the extension of the analysis to the whole world and over the whole of the gold standard period. In particular one should recall that capital markets did remain regulated[101] and that domestic monetary systems did not operate to the full strictures of the gold standard and were often hybrid arrangements.[102] Their research also demonstrates a close dependent (?) relation between Canada and the New York and London money markets which, might, given further investigation, confirm rather than infirm the importance of London.[103]

However, their view is that, "The Bank of England must surely have been only a bit player in the gold standard drama. The system operated beyond the influence of any country's authority. Countries stayed on gold because it ensured integrity of the domestic currency unit at little cost as long as the world gold supply and real exchange rates were relatively stable and there were no wars to be financed by inflationary means."[104] In theory given the assumption of the law of one price, particularly as determined through arbitrage in the goods market, and interest parity their model would prevail whether exchanges were fixed or not, but here they admit that adjustment to monetary shocks can have real effects. Finally, they deny that failure to follow the "rules of the game" could be responsible for the inter-war collapse as sterilization cannot work in an integrated capital market with fixed exchange rates and will only lead to asset substitution between domestic assets, foreign

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[100] This model closely resembles those adduced to explain the large trade imbalances which developed in the 1980s.

[101] see Feis (1974).

[102] However, Dick & Floyd (1992) argue that, "The traditional classical theory, except where it rules out capital movements entirely, is an ad hoc construction not based on fundamental principles. Allowance for imperfect capital mobility for which considerable historical evidence exists, in no way reduces the validity of this conclusion. Only in the case of perfect capital *immobility*, a case surely ruled out by the historical context being examined, is it possible to visualize the price-specie-flow mechanism as a logical extension of the model presented in this study."p.144. However, if capital flows are impeded not by transactions costs, but by policy then one can imagine capital market segmentation,- similarly in the case of high transactions costs, uncertainty, time/adjustment lags.

[103] see Kindleberger (1984) p.70.

[104] Dick & Floyd (1992), p.174.

assets, and gold. Rather they attribute the inter-war currency debacle to the increased or perceived costs of fixed exchange rates and the greater variability of real exchange rates.[105] But according to their model real exchange rates should move to reflect shifts in real factors and not subject to sudden revision. In a world in which one introduces nominal wage fixity, substantial monetary and real shocks (viz., sharp drop in commodity prices) one can soon move from a harmonious world of equilibrating capital flows to one characterized by falling output, lost confidence and speculative capital flight.[106]

It is perhaps easiest to conceptualise the difficulties with the Dick & Floyd model by analogy with the banking school arguments. Dick & Floyd fail to take into account the possibility of cumulative credit expansion or contraction in a fractional reserve banking system. In essence Dick & Floyd argue that domestic financial intermediaries enjoy no autonomy. Additionally even if one grants the principle of capital market arbitrage, this does not invalidate the ability of the monetary authorities to control the short-term rate of interest by increasing or decreasing the money supply. To therefore aver that the central bank enjoys no autonomy and that the money supply is endogenous may be true in the long run, but not in the short run. Therefore, the bullionist critique of the banking school argument and the possibility which adherence to such principles involves in terms of destabilising credit inflations, and by inference deflations, remains. This is aptly borne out by French experience during the 1930s.

It is interesting to contrast the Dick & Floyd model to the analysis of the gold standard adumbrated by de Cecco.[107] Both these studies explore the nature of the gold standard from an analysis of the relations of two states between which close links are maintained in terms of economic relations and capital market integration, and come to strictly different conclusions. De Cecco's "Jewel in the Crown" thesis examines the relations

[105] Dick & Floyd (1992), p.173.

[106] Even today capital flows are far from being prompted by rational economic forces. The large capital inflows into the US at the end of the 1980s were to a significant extent financed by the official sector and by Japanese financial institutions strong-armed by their authorities, thereby forestalling dollar depreciation and pressure on the domestic traded goods sector. However, it follows from Dick & Floyd's analysis that to attempt to stabilise currencies at some estimate of purchasing-power-parity or to restore the balance of trade is faulty without addressing the fundamental savings/investment gap. To do so, as Japan was prompted to do in the mid-1980s, in order to increase domestic absorption to pre-empt calls in the US for trade protection, risks having the distortion appear somewhere else, - as it did in the Japanese asset bubble.

[107] see Money and Empire (1984).

between India and sterling, and argues that the UK exploited its political influence to force India's official balances to be held in London mainly in British government financial instruments,- as a result the UK enjoyed an unrequited transfer (*seigniorage*, tempered by the rate of interest paid on these investments). According to de Cecco without this inflow and the cushion that it provided, the UK balance-of-payments position would have much weaker casting doubt on the UK's ability to maintain the gold standard in its absence.[108] De Cecco's "*dependencia*" theory of the gold standard, though focusing on the relation between the UK and India, maintains the centrality of sterling within the international monetary regime. Though de Cecco argues that this was due to the happen-chance of historical circumstance, arguing that Paris had been knocked-out by the Franco-Prussian war whilst Berlin and New York had not yet developed. De Cecco argues that one of the strengths of London were the British joint stock banks which made large sums available through the London money market to finance international trade.[109]

Whilst stressing the degree of capital market integration he emphasises the political quality of these flows, casting doubt on the ideal capital market type hypothesis postulated by Dick & Floyd. De Cecco also adduces a neo-Marxist model to explain the structure of the UK trade account, "...Britain strove to keep her Empire industrially under-developed while she tried to bolster its ability to earn foreign exchange as an exporter of primary commodities,"..."But at the same time, by keeping the Empire, particularly India, under-developed, British industry became geared to a static, under-developed market, which could not absorb more than a certain amount of industrial commodities, while it generated higher and higher foreign trade surpluses with the rest of the world by selling primary commodities. It thus became necessary for Britain to control those surpluses, which really meant controlling the monetary policy of her Empire."[110]

In addition de Cecco argues that the UK with its centralised money market could attract balances by means of discount rate changes, whilst other countries had to maintain a

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[108] Quoting de Cecco (1984), "The evidence we have examined clearly points to the fact that, in this period, the pivot of the international settlement system was India."p.35.

[109] Though one should note that this point sits ill with de Cecco's assertion that the British financial system did not constitute an harmonious hierarchical financial system (op.cit., pp.101-102) at the apex of which stood the Bank of England,- which was Bagehot's thesis q.v., Lombard Street (1888).

[110] De Cecco (1984), pp.37-38.

double defence consisting of foreign exchange (to insulate the domestic money supply from short-term movements in the current account) and gold, as ultimate backing for the currency. He argues that the relation between centre and periphery could only obtain so long as the former's political sovereignty went unchallenged.[111]

De Cecco argues that there was no deliberate international gold standard policy, rather countries went on gold depending on the balance of social forces within countries. The prominence of agriculture in Latin America and large *latifundia* explain the ascendancy of silver and easy money, whilst he argues that in Japan large industrial imports and lack of substantial primary commodity exports explain the adoption of the gold standard. De Cecco cites Hungary as an example of a country where agricultural interests eventually favoured adoption of a gold standard following the unsettling effects of sharp movements in the ratio of gold to silver prices in the 1890s. Schwartz (1987) suggests that one attraction of the gold standard to countries in the 19th century was that it made them more appealing as debtors, and promoted capital inflow as a result of exchange stability. The costs of borrowing in order to acquire gold reserves being outweighed by the benefits which easier borrowing would bring. De Cecco's Marxian interpretation of the domestic forces pushing for, or against, the adoption of the gold standard can analogously be used to understand the rate at which the franc was stabilised in the 1920s.[112]

According to de Cecco India's surplus with the rest of the world and deficit with the UK allowed the latter to finance its settlements on current account. The UK could, as a result, reinvest abroad its income earned from its foreign assets, providing liquidity to the international monetary system and a relatively free capital market.[113] The Indian balances were also used during the Boer war when the government of India's gold reserve was used

[111] De Cecco (1984), p.57.

[112] see Keynes (1923); and Eichengreen.

[113] Quoting de Cecco (1984), "The reserves on which the Indian monetary system was based provided a large *masse de manoeuvre* which British monetary authorities could use to supplement their own reserves and to keep London the centre of the international monetary system."p.62. And, "The basic importance of India as the main stabilising element should now be clear. Britain was able to depend on an economy which had a large export bias and thorough dependence on Britain for imports, and which was underdeveloped enough to generate a surplus that could be invested in London. Thus, the City of London could maintain its leading position both in short-term international finance and in long-term investment, and could remain, until 1914, the main source of international liquidity."(p.121).

to buy UK gilts, thus bolstering the credit of the state.[114] De Cecco argues that the main object of the India Office in managing the Indian surplus was to avoid its conversion into gold and invest in UK financial instruments to the tune of some £40-60 millions sterling a year in the period 1900-1914.[115] This diminished *pro tanto* the real transfer which the UK would have to make and eased pressure on UK bank rate.[116]

De Cecco points that even before the war the international monetary system was developing into a polycentric one with London, New York and Paris, with the latter acting as, "the world's ultimate gold reserve."[117]

De Cecco views monetary policy under the gold standard as discretionary. This explains the gold exchange standard. Peripheral countries maintained liquid foreign exchange reserves invested in short-dated paper in gold centres, viz., the UK, but also Paris and Berlin in order to intervene and avoid the strictures of the gold points. The *seigniorage* for the centre countries was the greater latitude offered in their balance of payments position than if these countries had preferred real resources to financial liquidity. However, he argues that the gold exchange standard could only work if the periphery had total confidence in the centre, which could only happen if they were politically subservient,[118] though the former does not follow from the latter. He sees already after the Boer War a move towards a pure gold standard as international tensions undermined the gold exchange standard fiduciary element and presumably as war chests were built-up.[119]

De Cecco admits that the issue of international financial liquidity was not costless to the UK economy, as UK bank rate was made more volatile by the seasonal drains associated with the harvesting and planting periods in the US.[120] This reverse *dependencia* thesis is

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[114] De Cecco (1984), p.70.

[115] De Cecco (1984), pp.70-71.

[116] Quoting de Cecco (1984), "By preventing India from transforming her surplus into gold reserves, the India Office contributed in no small way towards keeping British interest rates lower than otherwise would have been the case."p.71.

[117] De Cecco (1984), p.107; see also Eichengreen.

[118] De Cecco (1984), p.120.

[119] De Cecco (1984), pp.124-125.

[120] De Cecco (1984), p.122.

the converse of Ford's charge that it was the periphery that fully absorbed the costs of adjustment. Accordingly de Cecco argues, "...the United States was the largest disrupting factor and India the largest stabilising factor..."[121] Indian balances were used to smooth over the strain which seasonal drains imposed on the UK capital account. It is interesting to contrast de Cecco's political analysis of the workings of the gold standard and capital flows with the ideal apolitical type of the Dick & Floyd model.

De Cecco's exercise in the political economy of sterling and the gold standard constitutes a refreshing exercise in reminding economists that politics did intrude on the workings of the international gold standard and in illustrating the hybrid nature of the system, and in highlighting the relative inefficiencies of the capital market. This is illustrated by the entirely predictable seasonal drains which one would have expected to have been smoothed by way of arbitrage in an ideal world.[122]

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[121] De Cecco (1984), p.122.

[122] De Cecco's pre-eminently political analysis of the gold standard leads him to an extreme "Chartal" theory of money (see G.F. Knapp (1973); & Schumpeter (1981) pp.1090-1091) quoting de Cecco (1984), "Yet Money is simply that which the State declares from time to time to be a good legal discharge of money contracts."p.39. That may be so, but the State is unable to determine its value in terms of commodities or other currencies, in the long term. Even the most ruthless methods on the part of the State have failed (see F.Aftalion (1987), L'économie de la révolution Française). Locke long put paid to the illusion that the State could, "...raise the value of our money their double in respect of other commodities, and make that same piece or quantity of silver, under a double denomination, purchase double the quantity of pepper, wine, or lead, an instant after such proclamation, to what it would do an instant before."(quoted in, Andréadès, 1966, p.101). Though it is the case that the government through its statutory ability to determine in what form contracts shall be honoured, and tax payments made, has the ability to determine the relative distribution of wealth by altering the nominal price level. It cannot determine the value of money. To get round this problem of the variation in the value of contracted payments Jevons proposed a gold standard "as a means of exchange and common denominator of values." However, it would cease to be a standard for deferred payments. These would be indexed inversely to the shift in the purchasing power of gold, viz., to index against price fluctuations and avoid relative wealth effects arising from the balance-sheet aspect of inside money (see Schumpeter, 1981, p.1078). I.Fisher's proposal for 100% Money also aimed at producing a means of exchange which would also retain a fixed purchasing power as a store of value and unit of account by removing the ability of the banking system to produce cumulative inflation and contraction of credit and money. In this sense his views are close to Hayek's (q.v., Monetary Theory and the Trade Cycle). British policy-makers would also be concerned with stabilising the value of the unit of account. Hawtrey wished to stabilise the price of gold against commodities, as did Strakosch, whilst Keynes (1923) favoured a paper standard in order to economize costs. Keynes' standard would be stabilised to prevent prospective fluctuations in the currency's purchasing power rather than adjust its value according to a backward looking index, as proposed by Hawtrey and Fisher. Keynes was also opposed to stabilising the value of gold as such a substantial proportion of its stock was held by the Fed. and the institution was too young to be sure of its behaviour (Keynes, 1923, p.175).

BIMETALLISM:

It is perhaps useful to offer a brief excursus on the development of the gold standard and calls for bimetallism in the early 1890s. The former sheds light on the part accidental development of the gold standard, and the latter on an often forgotten period when the gold standard had many detractors. Gold acquired wider currency in the UK following the recoinage Act of 1696,- of which Locke had been one of the main promoters. The resulting new mint parities over-valued gold relative to silver and the subsequent downward revision of the gold content of the guinea (to 21 shillings), in 1717, following a report by the then Master of the Mint, Sir Isaac Newton, proved insufficient and gold continued to be the predominant metal brought to the mint.[123] The ascendancy of gold in the British financial system was effectively consecrated by the law of 1774 which provided that, only gold would constitute legal tender for payments above £50 sterling, and its fineness was laid down.[124] Silver was thereby reduced to the role of effecting small payments (*monnaie d'appoint*).

As has been chronicled the development of the gold standard is just as much due to variations in the price of silver than to anything else.[125] Historical experience confirms the greater strength of Gresham's law[126] as opposed to the bimetallist's claim that a bimetallic standard would tend to stabilise the price of commodities.[127]

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[123] see Vilar (1976), pp. 216-221.

[124] see Vilar (1976), p.285.

[125] see Cottrell, in, Broadberry & Crafts (1992).

[126] see Schwartz (1987).

[127] Quoting Schumpeter (1981), "This was the famous parachute effect, as Chevalier called it, that is to say, the effect of bimetallism to absorb the depreciating and to set free the appreciating monetary metal and so to stabilize the value of the monetary unit, at least so long as the latter was not entirely displaced."pp. 716-717. Kindleberger (1984) points out that the bimetallist argument rests on the proposition that the mint price will stabilise the market price of the metals. In practice, though, it is the market price which has destabilised the mint price, as a result of Gresham's Law (loc.cit., p.56). An historical instance of this occurred in the US during the Panic of 1893. Silver was over-valued and any coin found its way from the Mint to the Treasury. The latter decided to issue silver certificates from 1890 to economise on the costs of coinage (see Myers, 1970). Uncertainty over US monetary policy, the Baring crisis, a poor agricultural harvest in 1890, had all significantly reduced the Treasury gold reserve held against the currency issue. The customary reserve was considered to be $100 million, by beginning of 1894 this had fallen to $66 million (Myers, 1970). Following worrying gold losses President Grover Cleveland sought repeal of the Sherman Silver Purchase Act of 1890 which had inflated the money supply. The Sherman Act was repealed toward the end of 1893, but the government had to issue several gold loans to replenish its reserves. However, the President's policies proved unpopular and Bryan won the Democratic nomination. The party split and Cleveland's supporters the "Gold Democrats" formed a rump

The bimetallist controversy warrants mention because it marks a period often forgotten when the merits of the gold standard came under considerable attack. The circumstances of this attack are rooted in the extreme price fluctuations which characterised the gold standard period. In fact it is purely the effect of coincidence that studies which take the gold standard period as a whole tend to show a remarkable stability of prices during this period, viz., that gold prices had returned in 1913 to levels prevailing in the 1870s.[128] The period masked a long downward price cycle from the 1873 to 1896 and then upward price cycle to the First World War. Declining prices prompted debtors and the agricultural sector in the US to call for free silver coinage.[129] The campaign reached its zenith in the US elections of 1896 when the US silver and agricultural interests rallied round William Jennings Bryan's campaign crusade against humanity's crucifixion on a "Cross of gold."[130] Bryan's defeat in 1896 and the South African gold discoveries of the 1890s put paid to this, so that

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party the "National Democratic Party." Bryan was also nominated by the Populist party which also favoured an income tax rather than a tariff as a revenue source (Kruschke, 1991). Individual income tax was only introduced in the US by constitutional amendment in 1913.

In essence the silver lobby aimed at turning the internal terms of trade in favour of the agricultural sector and redistributing wealth in favour of debtors. It pitted the western silver and agricultural interests against east coast finance. Debtors versus creditors, farmers against industrial interests,- in many cases the parties that lobbied for free silver coinage also inveighed against the Trusts and Cartels. East coast finance favoured the gold standard and industrial protection in the form of a tariff. These conflicting interests that underlay the struggle between those favouring a gold standard and those supporting free silver coinage conspire to support de Cecco's Marxian political interpretation of the gold standard rather than the apolitical model often adduced in its defence.

The Republican ascendancy was consecrated with the Gold Standard Act of March 4th, 1900, placing the US on a mono-metallic gold standard (q.v., Encyclopaedia Britannica, 1966, vol.22, p.783; and Myers, 1970). With this historical experience in perspective one can more readily understand Roosevelt's policies. They represented, in a sense, the victory of the more populist inflationary lobby which had always found a place in the US polity from A.Jackson to W.J.Bryan. One should note that the Thomas Amendment to the Agricultural Adjustment Act (tellingly both were linked in a single piece of legislation) also carried a provision for silver purchases. Eichengreen (Golden Fetters) remarks that one reason that Roosevelt went ahead with this policy and the Thomas Amendment was to forestall any more inflationary initiatives coming from Congress.

[128] see Keynes (1923) p.158.

[129] For a contemporary review of the debate during this period see, F.W. Taussig, The Silver Situation in the United States (1969; first pub. 1896).

[130] The speech was delivered at the Democratic convention held in Chicago in 1896 where Bryan received the Democratic nomination. This was a reaction to the unpopularity of the incumbent Democratic President Grover Cleveland, owing to the economic depression and the President's advocacy of the gold standard. However, Bryan lost the election against the Republican candidate, William McKinley, both in 1896 and 1900. He would lose the presidential election again, as Democratic nominee, in 1908, against the Republican William Howard Taft.

Marshall could refer to the gold standard as the "natural order of things."[131]

Though Marshall had proposed symetallism, essentially an electrum standard with varying proportions of gold and silver dependent on the relative evolution of their respective purchasing powers, in order to stabilise the value of the unit of account and store of value.

It is apparent from the foregoing that the world which the Cunliffe Committee report sought to recapture was the brief window of prosperity in the period from the mid 1890s to the outbreak of the First World War. However, we find the Marxian argument that, recreating the *belle-époque* gold standard without its socio-economic and political underpinnings was a futile exercise, compelling.[132]

Additionally one should note that price movements were less easy to predict and more variable under the gold standard than under Bretton Woods. Though they were more so during the inter-war years.[133]

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[131] see Cottrell, in, Broadberry & Crafts (1992). Schwartz (1987) points out that the bimetallists were perceived as debtors interested in inflation and that the 40% price rise form the 1890s to 1913 meant that the movement lost vigour. Keynes (1923) also makes the point that the gold standard was unpopular whilst prices were falling,- which fuelled the controversy surrounding bimetallism,- until the South African gold discoveries. *op.cit.*, p.158.

[132] viz., the gold standard represented the political ascendancy of the bourgeois *rentiers* class. In the reconstituted post-war gold standard the balance of social forces would not allow the sort of adjustment to real shocks that might have occurred in its pre-war guise. Quoting Sir Henry Strakosch to this effect, "Postwar experience has amply demonstrated that it is politically and socially impossible to debase, even temporarily, the living standards of actively engaged producers, in order to restore equilibrium between costs and selling prices." and, "...the logical conclusion is that the avoidance of violent fluctuations in the level of prices must be the supreme aim of monetary policy." in, Gayer ed., (1937) p.176. Redmond (in, Broadberry & Crafts, 1992) points out that though wages and prices did not evince greater inflexibility during the inter-war years compared to the pre-war years, the shocks administered were larger and flexibility needed to be that much greater. With respect to the thesis that the gold standard represented the objectification of the interests of the *rentier* class one should note that to the extent that portfolios were dominated by fixed income instruments, e.g., bonds, rather than equities, which offer indexation against inflation, the *bourgeoisie* would favour the insurance against government currency inflation which the gold standard presented and fixed exchange rates to protect foreign investments.

[133] Eichengreen, in, Broadberry & Crafts (1992), p.56, points out that though the standard deviation of prices under the gold standard might appear lower in the four decades prior to 1913, prices were no easier to predict. One should add that during the Bretton Woods era they were far easier to predict as the whole period was characterised by accelerating inflation.

CREDIBILITY AND CO-OPERATION AS ESSENTIAL ATTRIBUTES OF THE GOLD STANDARD:

The most recent authoritative survey of the international gold standard, by Eichengreen which covers the period 1870-1939,[134] lays stress on two particular facets of the pre-war gold standard which were eroded by the legacy of the First World War. These were credibility and co-operation. It is essential to Eichengreen's thesis that the pre-war gold standard was collaborative and to an extent multipolar. This is not to deny the pre-eminent role of sterling, however it is his judgment that without credibility, which ensured stabilising capital movements in response to interest rate changes, and co-operation, in times of crisis, the pre-war gold standard would not have evinced the same qualities of relative stability.

It is Eichengreen's thesis that credibility ultimately rested on the acceptability of the gold standard, the post-war world would become increasingly characterised by domestic politicisation of the economic debate, particularly with the rise of labour and social democratic parties,- what we have dubbed a Marxian interpretation of the gold standard and inter-war currency system. The legacy of war finance and reconstruction would leave a substantial fiscal burden which would have to be financed, the resulting struggle over the distribution of the burden would undermine credibility, and often the outcome would be an inflationary increase in the note circulation, as in France in the 1920s. The fact that neither social forces,- those representing financial orthodoxy, nor those of the left, which favoured a capital levy, e.g., in France,- were pre-eminent made for an often protracted fiscal struggle.[135] Not until the costs of currency depreciation and inflation became too acute was a compromise forged. The tangible expression of this fiscal compromise was the rate of stabilisation against gold,- hence, according to Eichengreen, one of the most significant

[134] see <u>Golden Fetters</u>.

[135] Keynes (1923) saw with prescience that, "The level of the franc exchange will continue to fall until the commodity-value of the francs due to the *rentier* has fallen to a proportion of the national income, which accords with the habits and mentality of the country." p.73. It was therefore easier for countries which suffered hyper-inflation to stabilise as the internal debt burden had been largely extinguished, thereby resolving any disputes over the relative burden of adjustment which would arise from any given exchange rate parity. The experience of inflation also helped concentrate minds on the need for a stable exchange.

reasons for the reluctance of the authorities to devalue once stabilisation was achieved.[136] This politicisation of the economic debate helped undermine credibility and it is Eichengreen's thesis[137] that this loss of credibility should have been offset by co-operation.[138]

R.N.Cooper (1992) in his review of Golden Fetters has correctly taken Eichengreen to task for advocating co-operation in the international monetary arena to support a system which was untenable both domestically, in terms of the adjustment costs which it imposed, and, perhaps, less cogently, because gold production would be insufficient to provide international liquidity. Co-operation in Cooper's mind would only postpone collapse of the system.[139]

In favour of Eichengreen's suggestion that co-operative reflation would have been a first best solution, an opinion that Hawtrey would have shared, one should note that unilateral action ran the risk of currency flight and loss of gold reserves and, therefore, a contraction of the money supply and monetary base. Therefore unilateral reflation would not be possible excepting suspension of the gold standard and accompanying measures, such as a strong fiscal stance, to underpin credibility and staunch fears of a monetary inflation once the constraints which the "golden fetters" imposed had been removed. We will argue that the pessimistic unilateralist scenario characterised the French devaluation (s) as the financially orthodox in the French political and policy-making establishment had foreseen.

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[136] Quoting Eichengreen (Golden Fetters), "The early 1920s had been marked by inflation, social turmoil, and political instability. Only when domestic interest groups had agreed to compromise over the distribution of incomes and the burden of taxation and had sealed their compact by reimposing the gold standard had this chaos subsided. Central bankers hesitated to capitalize on the suspension of the gold standard until they were convinced that the same would not happen again."(p.292).

[137] see Golden Fetters.

[138] In a fixed exchange rate regime one either needs an N-1 currency (Stackelberg leader), commodity peg, or co-operation. Quoting Eichengreen, "Did international forces cause the Great Depression?", (1988), "In effect, the Old Lady of Threadneedle street was the Stackelberg leader of a noncooperative gold standard game in which she formulated policy keeping in mind the anticipated reaction of foreign central banks."(p.107)

[139] Quoting Cooper (1992), "I believe Eichengreen's emphasis on the importance of lack of cooperation is overstated - not because he has characterized incorrectly the importance of cooperation in managing a gold standard system, but because when a system is structurally flawed cooperation can possibly postpone, but it cannot altogether avoid, collapse of the system." (p.2127). Cooper concludes, "Both credibility and cooperation proved to be inadequate in 1931, although as noted above I would give more weight to structural flaws (ultimately leading to lack of credibility) and less to cooperation than does Eichengreen." (p.2128). This reflects very much the substance of my own *critique* of Eichengreen's conclusion.

According to Eichengreen co-operation was undermined by the legacy of war debts and reparations which, during the inter-war years, conspired to sour international monetary relations and bedeviled international monetary conferences such as Genoa, and Lausanne, and affected the international reaction to the German banking crisis of 1931.[140] Eichengreen argues that co-operation was more important in the inter-war years as the legacy of war had upset the international balance of payments and made Europe, particularly central Europe, reliant on US capital inflows.[141] Eichengreen argues that it was a wasted opportunity to have saddled the B.I.S. with reparations, as it precluded formal US participation and prevented its use as a formal forum in which co-operation might be mediated.[142] Even when co-operation was agreed to be the best solution it was impaired by differing conceptual frameworks,[143] e.g., ahead of the 1933 London World Economic Conference the French were keen on co-operation by which they meant a commitment to maintaining the gold standard, whilst the UK conceived co-operation in a joint effort to raise world commodity prices. One should note that a co-operative solution had by then become of less interest to both the UK and US authorities who had, by suspending gold convertibility, gained the opportunity to take unilateral measures. The exchange rate constraint having been removed.

According to Eichengreen co-operation would have restored credibility and allowed central banks to act as lenders of last resort.[144] The lack of co-operation prevented any unilateral effort at combating the depression. It is intrinsic to Eichengreen's thesis that unilateral stabilisation was not possible outside a co-operative venture.[145] However, as

[140] see Golden Fetters.

[141] Quoting Eichengreen (Golden Fetters), "The pattern of international settlements, and the stability of the inter-war gold standard itself, therefore hinged on the continued willingness of the United States to recycle its balance-of-payments surpluses."(p.392).

[142] However, the BIS was deliberately created to try and resolve the reparations problem once and for all.

[143] Quoting Eichengreen (Golden Fetters), "Different experiences with inflation during and after the war bequeathed competing conceptual frameworks that impeded efforts to agree on a common response to international monetary problems,"(p.392); and again, "But, international political disputes, domestic political constraints, and incompatible conceptual frameworks proved insurmountable obstacles to cooperation." (p.393). One should note, though, that those countries which had returned at new (lower) gold parities were thereby able to sustain the deflationary shock for longer and thereby forestall devaluation.

[144] see Golden Fetters, p.262.

[145] see Golden Fetters, p.286.

Eichengreen implies it was not just the gold standard but the "gold standard ethos" which needed to be replaced,[146] by which we take it to mean the minimalist role of the state, this change is particularly illustrated by the socialisation of risk arising out of bank default in the US under Roosevelt (though the social costs of associated with "moral hazard" should not be ignored),[147] less cogently though Eichengreen's argument might be considered to encompass an indictment of fiscal orthodoxy. In the case of France devaluation and large budget deficits did not conduce to restoring confidence, particularly when accompanied by a sharp reduction in the discount rate. This is not to argue against a cyclically adjusted fiscal stance, but more often than not this results in continual deficits, and in the context of the 1930s the combined sundering of the "golden fetters" and apparent abandonment of fiscal rectitude only conspired to further weaken the currency.

The absence of co-operation and the failure of the US to recycle surpluses from 1928 onwards and the sterilisation of international liquidity by the two great world gold reserve centres, viz., New York and Paris, meant that countries had to deflate to adjust, reducing domestic money supplies and imposing perverse macro-economic policies. The mechanism whereby deflation spread was across the fixed exchanges from the US. When deflation and falling agricultural prices in the US threatened to impair the domestic banking system authorities were confronted with a policy dilemma, viz., maintaining the gold standard precluded any unilateral action and suspending the gold standard in central European countries, in particular, was considered a forerunner to potential hyper-inflation,- given the immediate post-war experience of most of these countries,- whilst for others it was a step reluctantly taken more often than not when investor sentiment and confidence was already so eroded, or when the political costs of pursuing a fixed exchange rate policy undermined the very credibility of that commitment. In the US, however, the decision to suspend the gold standard was deliberate and unilateral.

As we have noted McCloskey & Zecher tend to reject the Friedman/Schwartz hypothesis of the spread of depression of which Eichengreen's latest *opus* is a further development, albeit from a global and international perspective. However, they are not

[146] see Golden Fetters, p.393.

[147] One should note that the Federal Deposit Insurance Corporation may well have been a significant contributor to increasing the money multiplier by reducing the perceived risks of holding bank liabilities (viz., deposits) as opposed to cash balances.

incompatible in the sense that it is the process of deflation and price adjustment across the exchanges which spread depression, compounded by perverse fiscal policies. The difference lies in that McCloskey & Zecher tend to brush off the adjustment path and seem to implicitly suggest that money is but a veil over underlying real activity, whilst in fact credit and thereby money are intrinsic to the very process of the capitalist economy.[148]

The importance of Eichengreen's contribution is that it stresses the impact of the disequilibrium adjustment path and the non-neutral distributional effects of a process of adjustment which demands falling prices (in the absence of rising prices in the reserve acquiring countries), the effects that this has on real interest rates, real debt burdens,[149] and the premium that this environment lends to idle balances. These factors are crucial to understanding the impact of this sort of deflationary squeeze. When married to perverse macro-economic policies imposed by financial orthodoxy they can largely explain the depths of depression. Once the "golden fetters" were abandoned and gold convertibility suspended governments could obtain control over one of the essential levers of economic policy and loosen credit conditions.

This should help explode two myths about the inter-war years which gained wide currency as a result of Nurkse's work for the League (1944) and which were in a sense the underlying premises of the Bretton Woods system. These were, that currency depreciations had been competitive and beggar-my-neighbour; and that these had precipitated tariff protection. On the contrary currency depreciation was a prelude to economic recovery, and tariff protection arose directly from the deflationary impulses transmitted across the fixed exchanges. Eichengreen cogently argues that more countries should have depreciated earlier, preferably co-operatively. One should also note that tariff protection began before exchange dumping took place and that trade liberalisation only followed currency depreciation.[150]

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[148] One should note a further distinction between McCloskey & Zecher, and Dick & Floyd, and that is that the latter recognize an intrinsic link between economic activity and credit/money, albeit whilst still adhering to the neutrality of money hypothesis.

[149] see I.Fisher (1933).

[150] Quoting Eichengreen (1988), "Did international economic forces cause the Great Depression?", "However, the salient criticism is not that countries depreciated their currencies but that more countries did not adopt this policy and that those that did failed to push it far enough."(p.112). Eichengreen also points out that, "The US Smoot-Hawley Tariff Act of 1930 came too late to account for the 1929 downturn and fails to explain the severity of the contraction in the US. The competitive devaluations of the 1930s redistributed the Depression's effects across countries but did not worsen it overall. The deflationary consequences of the

Finally, Eichengreen explains this uncompromising stance toward the depression in the US to a false analogy with the sharp recession of 1920-21 and the policy of "liquidation" then pursued, following the post-war boom.[151] The slump in economic activity had been short and followed by recovery. Eichengreen argues that policy-makers in the US used this experience as a referent during the 1929-33 depression and justification for the largely quiescent policy stance, though H.Stein (1969) has demonstrated that the passivity of the Hoover administration has been over-played.

Eichengreen points out that the analogy with the experience of 1920-21 was misplaced and that the rest of the world had been largely sheltered from the deflationary forces emanating from the US in the 1920s, as most of countries enjoyed floating exchange rates and were, thus, insulated. Furthermore, their failure to pursue policies as restrictive as in the US caused a large gold flow towards the US which allowed for subsequent monetary policy relaxation. The experience of 1920-21 had therefore masked the extent to which shocks could be transmitted across the exchanges and the extent to which the rest of the world would become dependent on capital inflows.

Quoting Eichengreen in reference to the experience of 1920-21, "The policy of liquidation, Federal Reserve officials concluded, had only salutary effects. What they failed to realize was that the success of the policy had been contingent on the foreign reaction, a

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liquidation of foreign exchange reserves were minor. Domestic central bank policy and their failure to be coordinated internationally must bear the major responsibility for the Depression."(op.cit., p.90). Eichengreen does make a cogent point that tariff protection in the US would have beneficial expenditure switching effects. However, we would take issue with Eichengreen's static zero sum approach to depreciation. Clearly it was unhelpful for those countries that did not devalue and had a cumulative negative impact, e.g., downward pressure on domestic prices; adjustment through falling domestic output due to supply-side rigidities; falling budget revenue; and the asymmetric impact on activity of deflation. However, it was the only way to recovery and, as such, those countries which failed to devalue must bear responsibility. This is not to deny that unilateral action, by precipitating a movement towards foreign exchange liquidation was not deflationary, but in all cases currency depreciation came after the Depression had run for several years. One could add that depreciation was beneficial as it helped force countries off gold sooner than might have been the case. Much of this is pertinent to the charge that the UK is currently (Spring 1993) practising exchange dumping within the European Community.

A forerunner of Eichengreen's argument is Copland in, Gayer, ed., (1937), "The critics of depreciation deplore the race for currency depreciation setup amongst the nations as disturbing to world trade and paralysing to the internal economy of countries that do not take the step. What is the alternative to competitive currency depreciation? Surely, competitive economic deflation, though slower in operation, is much more disastrous than competitive currency depreciation, because it accepts the fact of a lower price level and an increase in the value of the unit of currency. Thus it adds to the difficulties of adjustment by lengthening the process and creating a new problem of debt adjustment."(p.413). The volume of essays edited by Gayer offers a compendium of early monetarist interpretations of the inter-war depression.

[151] see Golden Fetters, pp.120-124.

reaction that was possible only because the gold standard had not yet been restored. The situation would be entirely different when recessionary tendencies once again became evident in 1929."[152]

However, the domestic experience of financial crisis in many European countries during the post-war boom and slump under floating exchange rates had encouraged the authorities to look to the restoration of the gold standard.[153] Though one should not lend too much weight to this as there was no question, in France at least, of not returning to gold. However, of very real subsequent significance in conditioning response to depression, particularly in France but in other countries too, would be the experience of currency depreciation, inflation, and fiscal crisis and accompanying, and concomitant, political instability in the early post-war years.[154] Policy-makers were adamant that once stabilisation had been achieved the gold standard should not be abandoned, for fear of further turbulence.[155]

Eichengreen explains the muted effect abroad of the slump of 1937 to the fact that, "Liberated from the gold standard, other countries were not forced to match deflationary policies in the United States with their own deflationary initiatives. There was little

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[152] see Golden Fetters, p.124.

[153] see Golden Fetters, p.107.

[154] France's experience was not so much characterised by inflation, but by currency flight. Kooker (1976) correctly points out that in France inflation was thought of more in terms of an increased note circulation, whilst anglo-saxons thought of inflation as an excessive price inflation. In fact in France domestic economic agents rather than bid up the price of domestic goods and assets (flight into real assets) preferred to acquire foreign financial assets.

[155] Quoting Eichengreen (Golden Fetters), "The single best predictor of which countries in the 1930s allowed their currencies to depreciate and pursued reflationary initiatives, instead of clinging to the gold standard or adopting equally stifling exchange controls, was the experience with inflation a decade before. Countries that had endured persistent inflation in the 1920s were loath to permit currency depreciation and to expand their money supplies. They continued to associate depreciation and monetary expansion with inflation, even in the midst of the most catastrophic deflation of the twentieth century. They showed remarkable persistence in rejecting arguments for devaluation and reflation in the face of incontrovertible evidence of their beneficial effects in other countries."(p.394). It is interesting to note that in the UK until black, or white, Wednesday (depending on your point of view) 16th September 1992, the authorities were obsessed with the past asset inflation of the second half of the 1980s and using a fixed exchange parity to anchor expectations, whilst the real problem was asset deflation and real balance sheet shrinkage, the policy became in-credible and as in France during the latter half of the 1930s the government had to unwillingly abandon its exchange rate policy with far more damaging costs both political and in terms of its credibility, than if this had been the object of deliberate choice. It would have, in both cases, saved foreign exchange/gold reserves.

tightening of monetary conditions outside the United States."[156] On top of this there was not, "much fiscal retrenchment abroad,"[157] as rearmament proceeded apace and the US soon reversed policy.[158]

Additional explanatory factors for the rapid recovery was that in 1938 the sterling area depreciated, and France and Japan allowed their currencies to depreciate too as they lost gold. Eichengreen constantly stresses the fact that devaluation, or floating, allowed an autonomous relaxation of domestic policy.[159] He ascribes economic recovery to an increase in domestic demand rather than to any trade related multipliers.

Eichengreen points out that in 1937 Latin America, central and eastern Europe insulated themselves from the deflationary forces coming from abroad by tightening exchange controls.[160] Eichengreen argues that Sweden and Denmark illustrate the fact that once the exchange rate constraint had been lifted the central bank acquired autonomy to act independently.[161] In the case of Sweden to provide liquidity to the market following the Kreuger scandal in 1932, and in Denmark allowing it to follow expansionary open-market policies. A lesson clearly lost on today's generation of Scandinavian policy-makers, who were eventually forced to abandon their currency pegs to the deutschmark/ERM.[162]

As a final reflection on the gold standard one should note a rather telling point made by Triffin. He argued that the 19th. century marked the euthanasia of commodity currencies,

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[156] Golden Fetters, p.387.

[157] Golden Fetters, p.387.

[158] see Friedman & Schwartz (1963).

[159] see Golden Fetters, e.g., p.367.

[160] Golden Fetters, p.388; see also accompanying graph 12:8 which records industrial production in Europe and North America.

[161] see Golden Fetters, pp.306-308.

[162] This experience illustrates clearly the policy dilemma which Eichengreen has alluded to, viz., the difficulty of providing accommodation to the domestic banking system whilst defending a fixed exchange parity under pressure because of the domestic costs which it imposes. The markets took the view that the governments' position was untenable and forced them to abandon the chimera of nominal exchange rate fixity. Pedersen's judgment in this regard is suitably balanced, "It is not denied that it is convenient to merchants to be able to calculate in fixed exchange rates, but it remains to be proved that this convenience can balance the disadvantages which the obligation to maintain fixed rates would have caused in other respects." in, Gayer (1937) p.181.

viz., first silver and then gold.[163] Triffin points out that the period was characterised by the increased importance of credit or bank money. This is certainly true. Nevertheless, as Scammell has argued gold still played a significant role as a balancing item in the international payments mechanism.[164]

From the foregoing it is apparent that the ante-bellum gold standard was far removed from the text-book model. There was tinkering at the margins, viz., varying the gold points through the use of various gold devices, gold losses were not necessarily followed by a rise in the discount rate (though gold acquired with domestic exchange at the central bank would remove from circulation an equivalent amount of notes). There can be little doubt that the international role played by sterling, or at least London as a financial centre, in the pre-war international monetary system did contribute to stability in the international monetary system, at least in its North Atlantic guise.[165] Eichengreen quotes an estimate that, "60% of the world's trade was settled through payment in sterling bills,"[166] and he cites another source which indicates that Britain accounted for a substantially smaller proportion of world trade. This underlines the significant role of sterling as the world's predominant vehicle currency. Nevertheless, it is clear that the gold standard did not conform to the model described in the Cunliffe Committee Report.[167]

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[163] "All in all, the nineteenth-century could be far more accurately described as the century of an emerging and growing credit-money standard, and of the euthanasia of gold and silver moneys, rather than as the century of the gold standard." Triffin (1985) p.133.

[164] Quoting Scammell (1985) "... within the gold standard of the later nineteenth-century, sterling operated as an international currency on equal terms with gold sterling was for many countries the normal means of settling trade indebtedness and gold was transferred only as a balancing item, as, for example, when a country's commercial banks were called upon to make more payments to foreigners than were compensated by receipts."

[165] If only by providing relief to the New York money market during the periods of "seasonal drain" (q.v., de Cecco, 1984).

[166] see Golden Fetters, p.43, & footnote 45.

[167] "Even as an account of how the gold standard worked under nineteenth-century conditions the Cunliffe Committee's model had considerable weaknesses. It is fair to add, however, that little research had been done at the time on this matter. It may be that the British economy was more flexible in the nineteenth-century. It is certainly true that Britain's unique position at the centre of the system, the unrivalled facilities of the London capital market, and the healthy balance of payments enjoyed by Britain for much of this period, enabled changes in Bank Rate to act quickly on the flow of international funds, thereby reducing the need for drastic internal adjustments. But as later studies have shown, the gold standard did not guarantee price stability even during the nineteenth-century. Gold movements did not provoke automatic responses; they were more the shadow than the substance of the adjustment mechanism. It is also clear now that many of the strains were borne by countries on the periphery of the system, rather than by those, like Britain at its centre." From Winch (1969)

One should also note too that the more classical models adduced by both McCloskey & Zecher (1984), and Dick & Floyd (1992) by no means preclude an analysis which explains the depth of the depression to monetary factors. As we have seen the McCloskey & Zecher model in the disequilibrium guise developed by Hawtrey adequately explains the destabilising effects of gold flows. The Dick & Floyd model can also be interpreted as being destabilising if the foreign exchange product of capital inflows (viz., gold exchange standard) is precluded from acting as a basis for an expansion in the domestic money supply and gold is drawn instead, in which case the effect is to sterilise international liquidity. And assuming a relatively fixed nominal cost structure foist deflation on the country from which gold is drawn. This is consonant with Hawtrey's analysis of the impact of French monetary policy on the UK during the gold avalanche years of 1928-1932. The effects are compounded if the gold recipient state does not allow its gold reserve accruals to have a multiplier effect on its domestic monetary base and domestic absorption, as was the case with the US and France.

If in the disequilibrium variants of the McCloskey & Zecher, and Dick & Floyd models one assumes supply-side rigidities, e.g., a relatively "fix" nominal cost structure, this inflexibility means that adjustments will take place through quantity shifts which will have cumulative deflationary effects on output and government revenue, such a course will in turn prompt a perverse attempt to tighten the aggregate macro-economic stance, both fiscal tightening and monetary. Increased uncertainty in the face of depression and government deficits would follow (in France at least attempts at curtailing the deficits proved fruitless, q.v., chapter four), a gold outflow would follow, and interest rates rise. This occurred in the US following the UK devaluation as France attracted gold.[168] As economic activity drops so do the number of real bills discounted, justifying a passive attitude on the part of the authorities on the grounds that despite low (nominal) interest rates the demand for real bills discount has fallen. This was the official position of the Bank of France. In the US when this fall in real bills held in portfolio occurred the gold element of the reserve ratio had to increase *pari passu*, i.e., the amount of free gold declined justifying a relatively tight

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pp.76-77.

[168] Cooper (1992) points out that France's absorption of gold from October 1931 to 1932 caused the FRBNY to raise its discount rate from 1.5% to 3.5% in the midst of depression.

monetary stance.[169] The decline in prices would have the additional effect of raising the real rate of interest. And in the US failing banks would lead to a higher demand for cash balances as opposed to bank deposits and a cumulative decline in the money multiplier.

One should note that this perverse disequilibrium model of the McCloskey & Zecher, and Dick & Floyd models would suggest as a remedy that rules of the game or co-operation be followed. But, our opinion is that in the case of the US such a response to gold movements might well have been destabilising to the credit structure and similarly in France. Rather a monetary growth rate rule which aimed at stabilising the price level could have significantly attenuated the impact of real shocks.[170] Additionally an earlier resolution of the reparations morass, and of the revanchist Versailles mentality, would without a doubt have attenuated monetary instability in Germany and immeasurably reduced the political animus which so opportunely played into the hands of the Nazis.

AN HISTORICAL OVERVIEW OF INTER-WAR MONETARY HISTORY:

The First World War precipitated the accession of the US to world economic power status. The United States was, until the First World War a net debtor and until 1913 had no central

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[169] The passage of the Glass-Steagall Act, in February 1932, got round this perverse rule by relaxing the rules governing bank reserves and the eligibility of government paper. This widened the scope for open-market operations which had been limited by the amount of "free gold" which was available to back any addition to the currency issue, it also made it easier for the Fed. to offer assistance to banks by widening the collateral which it could discount. Quoting Friedman & Schwartz (1963), "Similarly, widening of collateral on which Federal Reserve notes could be issued was also completed by the Glass-Steagall Act, which provided that government securities in the Reserve Banks' portfolios were eligible as part of the 60 per cent other than gold required against Federal Reserve notes."(p.384). This faculty had been provided on an emergency basis and included the ability, "...to make advances to members banks on any asset."(p.191 footnote 4). The provisions of the Glass-Steagall Act were made permanent by the Banking Act of 1935.

[170] see Friedman & Schwartz (1963). This view is lucidly expounded by Eichengreen, in, "Did international economic forces cause the Great Depression?" (1988), "...the decline in money supplies after 1928 vastly exceeded the simultaneous decline in gold and foreign exchange reserves. In other words, most of the monetary contraction was due not to the decline in reserves but to the decline in money multipliers. Between 1928 and 1932, money multipliers declined dramatically not only in France and the US but also in Belgium, The Netherlands, Sweden and the United Kingdom. One cannot exonerate policy on the grounds that this decline in money multipliers was a consequence of the Depression rather than an initiating factor. This may be plausible enough, but central banks still can be indicted for failing to counter these effects. This suggests that it was not the liquidation of foreign exchange reserves so much as the overall policy stances of major central banks that caused the decline in money supplies worldwide and thus reinforced the severity of the Depression."(p.111). One should just qualify this by stating that the central banks were prompted to take this action both as a result of reserve losses and the prevalent real bills doctrine which guided central bank monetary/banking policy.

bank nor developed money and acceptance market.[171] The US had now become the world's largest creditor nation and accumulated a substantial gold reserve. The UK remained a net creditor, but its debtors especially France did not appear very reliable, nor did its claim to reparations. The UK agreed unilaterally to waive any war debt above and beyond its own liabilities in the so-called Balfour declaration.

The US had, until it entered the war in 1917, insisted that, before loans were made, purchases be financed from foreign assets to safeguard its neutral status. The US also lent balances principally to Britain. These were then lent-on to her Allies. This included funds used to support sterling and the franc during the war. This flow of funds ceased in 1919 and both currencies fell on the foreign exchanges, in particular the French franc from March 1919 when it was unpegged.

Britain now found herself a debtor towards the US which refused to reduce the capital sums due and acted as a hard-nosed creditor, whilst credits due to Britain were of a rather dubious quality. However, in order to re-establish her financial status Britain felt obliged to honour this debt. This brought the UK to a relatively onerous war debt settlement, in 1922, which was necessary to secure a stabilisation loan. The US returned to its pre-war gold parity for the dollar. Holland and Switzerland, both neutral countries, also managed to return to pre-war parities. But, Central and Eastern Europe found itself engulfed in a monetary maelstrom,- to paraphrase Beyen (1949).

One must sketch in brief outline the new political status of this part of the world. Poland, a newly formed state, with three concurrently circulating currencies was at war, with Russia, until 1922. Greece and Turkey were at war with each other. Russia was in the throes of Civil War and had two currencies circulating: the gold rouble and the chernovetz, the latter issued by the Treasury to finance the deficit and the former acting as a store of value.[172] Czecho-slovakia, a new state, virtually alone amongst central European nations, managed to stabilise her currency, by adopting a rigid budgetary stance. Hungary had internal political problems, following the collapse of the Dual-Monarchy which included both an attempted Habsburg restoration and a short-lived communist coup under Bela Kun. As a defeated power it had reparations obligations to meet and was soon suffering from hyper-

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[171] see Eichengreen Golden Fetters.

[172] see US Senate Gold and Silver Commission European Currency and Finance (1925).

inflation. Bulgaria also had reparations payments to meet. Austria, stripped of its Empire, liable for reparations payments, was also in a desperate situation and collapsed into hyper-inflation. Finally, central to European trade, especially as it appeared to the Bank of England, was, Germany: a defeated and politically unstable nation with heavy reparations liabilities to meet, foreign occupation of its soil and an Allied blockade. Germany gradually fell into the miasma of monetary chaos. Some of these countries were predominantly agrarian and, though, during the immediate post-war boom 1919-20 commodity prices rose, they soon fell. This downward trend lasted throughout the inter-war years. Further, compounding these problems, the new nation states also introduced tariffs and added impediments to trade. Many of these states had accumulated a large internal debt and had to cover such deficits as those on the railroads.

Before we look at policies adopted to stabilise European currencies I feel that it might be useful to dispel a commonly held belief, perhaps stemming from the "so-called Keynesian Revolution" that economists and "informed opinion" were inept and unwilling to try and comprehend the nature of the problems confronting them. Many were constrained in the strait-jacket of orthodoxy, which was not merely monetary dogma, but was the manifestation of deeply held liberal philosophical belief, though to be fair to Keynes his main reproach was that the UK had returned to gold at an overvalued parity.

When studying this period one is in fact amazed at the number of studies which were commissioned by governments (e.g., US Senate Gold and Silver Inquiry, 1925), conducted by the League of Nations and the bevy of international conferences and meetings of central bankers convened to analyze and attempt to address these problems. In fact, it contrasts very favourably with the present day rather hesitant official reaction to problems of stabilisation in former command economies. Though of course in the latter the problems are immeasurably more intractable (viz., the development of civil society) and are more complex politically and psychologically.

Returning to the supposed ineptitude of inter-war policy-makers one must mention that it is indeed true, that on the whole, analysts did not comprehend the extent to which a regime shift/change had occurred.[173] This illusion is encapsulated in the expression current in the UK of a return to "normalcy". This failure did contribute to the development of a potentially

[173] see Eichengreen Golden Fetters.

highly unstable financial system.[174] There existed an effective vacuum in the world financial system, co-ordination failed when it did not coincide with domestic policy objectives (as it had coincided in 1924 and 1927 when the US reduced interest rates to take pressure off sterling.[175] The international financial regime had in fact evolved into a system based on two and a half financial centres each with its own interests and policy objectives both domestic and foreign (which could and did clash see Moreau's memoirs). That a system was actually constructed on such a basis, particularly if one takes account of reparations and war debts, might seem more remarkable than its eventual collapse. But, it is much easier with hindsight, and particularly abstracting from political perceptions and realities to suggest more "optimal" policy prescriptions.

Eichengreen argues that it was not so much the appearance of new financial centres that distinguished the inter-war monetary system, but rather the lack of co-operation between them which made them apparently rival.[176] Eichengreen is of the opinion that other central banks as well as the Bank of England had been prominent in the pre-war years, in contra-distinction to Kindleberger who places far more weight on the putative central and commanding role of the old lady of Threadneedle street.

Eichengreen also stresses the importance in the international monetary system by the 1890s of international capital flows which facilitated the global balance of payments adjustment mechanism. And Eichengreen adds that, "Those capital flows depended on the credibility and cooperation that, by the 1890s, had come to provide the foundation of the international monetary system."[177] This was unsettled by war, reparations, war debts, and the fundamental deterioration of the UK balance of payments, in particular, which meant that the world would be even more reliant on such flows, but in times of crisis both cooperation and credibility proved wanting.

However, the often stated argument that the US did not concern itself with European affairs is to a great extent erroneous. Innumerable Committees were chaired by American representatives eg., Dawes committee, various stabilisation loan committees, the Transfer

[174] see Kindleberger; and Rueff.

[175] see Moggridge (1972).

[176] see Golden Fetters, p.30.

[177] see Golden Fetters, p.42.

committee (Parker Gilbert), the Young committee, the Wiggin/Layton committee leading to Standstill Agreements, Hoover moratorium and the efforts of Benjamin Strong. The first chairman of the BIS was an American, Gates Mc-Garrah (though his nationality did afford a political compromise).

The Cunliffe Committee report (1919) chaired by Lord Cunliffe, former Governor of the Bank of England, underlined the necessity of a return to gold. This objective was wholeheartedly supported by Montagu Norman, Governor of the Bank of England (1920-44). The Geddes Axe was applied to reduce public expenditure and the budget was eventually to be balanced. This type of deflationary policy was endorsed by the Bruxelles Conference 1920 and the Genoa Conference 1922.[178] The Bruxelles conference stressed the need to balance budgets and combat inflation. At the Genoa conference it was recognised that an all round return to gold might lead to a deflationary scramble for gold, hence a gold exchange standard was advocated as a goal for "satellite" or subsidiary central banks. The Genoa conference also recognised the role played by central banks in managing the pre-war gold standard. Traynor (1949) argued that this insight was lost in the post-war monetary order.[179]

At Genoa there was talk of stabilising the purchasing power of gold (an idea cherished by Gustav Cassel; see also Irving Fisher and his compensated dollar scheme),[180] but this was held in abeyance until the Gold Delegation was appointed in 1929. By the time the Gold Delegation's final report was published, in 1932, many countries were off gold. In fact France was reluctant at the time to support the convening of an international monetary conference as the Gold Delegation, and especially its forcefully worded dissenting minority

[178] It received the *imprimatur* of Keynes! (see Howson, 1973).

[179] "Another noteworthy contribution at Genoa was the recognition of the influence of central bank policy on credits, money, and exchange. Even before the war the policies of banks had a distinct influence on credit and on the operation of the gold standard. In the early post-war years, however, this seemed to be passed over and the pre-war standard was regarded as automatic. The Genoa resolutions indicated a recognition of the fact that the gold standard did not operate automatically and that the co-operation of central banks was a necessary directive force. Had this policy been put into effect international affairs might have taken a different turn." Traynor (1949) p.87.

[180] Schwartz, in, "Prospects of an International Monetary Constitution," (1987), mentions that Strong was not keen on this proposal as it might leads to a conflict between external and internal stability. "One of his objections centered on the conflict between the Genoa proposal that monetary policy should attempt to limit fluctuations in the purchasing power of gold and a central bank's duty to maintain domestic stability." Furthermore, Strong did not want to be in a situation where he might be strong-armed into providing relief to impoverished banks of issue (op.cit., p.22).

report, emphasised the problem of the maldistribution of gold and blamed France, in particular, for this.

The Genoa conference also considered convening a conference of central bankers under the aegis of the Bank of England to discuss central bank co-operation. However, this did not materialise and it is central to Eichengreen's thesis that this failure to realise a co-operative monetary framework,[181] which Montagu Norman sought, left central banks helpless before the spread of deflation from the US. The impact was felt across the exchanges, due to the constraint of maintaining exchange rate stability and the asymmetric adjustment mechanism of a non-cooperative regime in which the surplus countries absorbed international liquidity,[182] as a result monetary growth contracted in those countries subject to reserve losses.[183] Difficulties of balance-of-payments adjustment were compounded by the reverse flow of capital to the US from 1928.

The Genoa conference had been called in part to revive European trade and, in particular, that with Russia,- Lloyd George's pet idea. A revival of trade would also assist the reconstruction of the international financial regime.[184] To secure US participation the conference was called outside the League of Nations framework and was inter-governmental in character. The US made their participation conditional on the express guarantee that war debts would not be discussed. And the French would insist that reparations not be up for negotiation. Thus, the major impediments to a favourable climate for international monetary co-operation were deliberately kept off the agenda at successive inter-war monetary conferences.

The post-war gold exchange standard resulted in international liquidity being pyramided on the gold reserves of the major central banks. This policy did not mark a real departure from pre-war practices. The difference lay more in the existence of new

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[181] see Golden Fetters, p.222.

[182] **Under Bretton Woods the opposite was true, the US provided liquidity to spare until the inflationary costs of absorbing it became too great.**

[183] **see Golden Fetters, p.223, for figures.**

[184] **"The widespread adoption of the gold standard and the prestige which the gold standard system acquired were partly attributable to this cause. Assured exchange stability was an important, if not an essential, condition of large-scale international investment, and hence it became the first desideratum of a monetary system that it should ensure exchange stability." from R.I.I.A. The Problem of International Investment (1937) p.4.**

international financial centres and in particular New York.[185]

Eichengreen (Golden Fetters) is not so much concerned with the pyramiding of credit than with the lack of international co-operation and irritants to co-operation which war debts and reparations constituted, which meant that credibility would be impaired in times of strain and capital flows would take the form of destabilising outflows or "hot money." Eichengreen argues that credibility was such in the pre-war gold standard that capital flows, in response to a rise in interest rates, led to stabilising capital inflows. This, of course, applies first and foremost to the UK.

The pyramiding of credit on various gold centres was later condemned by French policy-makers as the cause of inflationary finance and the instability of the international monetary system. Amongst those critics we find the gold "fetishists" Palyi (1972),[186] Rueff, v.Mises, Rothbard (1983), and v.Hayek, and implicitly Kindleberger. The French were particularly reticent about the merits of a gold exchange standard regime which they perceived as a means for Britain to avoid the strictures of a full gold standard and which would allow the Bank of England to exercise inordinate influence (see Moreau's memoirs).[187] French policy-makers and analysts, e.g., Aftalion, would argue that sterling was forced off gold because the Bank of England sterilised, by means of open-market operations, the "natural" adjustment mechanism which gold outflows should have set in train. However, it can hardly be said that the Bank of England's policy led to boom conditions in the UK in the 1920s! Conversely, Hawtrey would argue that France sterilised the impact of gold inflows and that this was one of the major causes of international financial instability.[188] During the 1930s France and the US accounted for circa 60% of world

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[185] see Kindleberger (1973).

[186] Palyi had been economic advisor to Deutsche Bank from 1928-1931, and from 1931-1933 director of the Reichsbank's Institute for Monetary Research. see Palyi (1972).

[187] Silverman (1982) seemed to share this view, "It is difficult to avoid the conclusion that the gold-exchange standard was at least in part a scheme devised to restore Anglo-American hegemony over the international financial system." p.58. The argument would be disinterred in the 1960s by de Gaulle and his financial adviser Rueff to accuse the US of exercising an inordinate privilege in the international financial regime through the key currency role played by the dollar within the Bretton Woods system. The question revolved around the degree of *seigniorage* which the US enjoyed.

[188] Hawtrey rejected this and argued that, "What has brought about the credit deadlock of the years since 1930 has not been "a reaction from a riot of inflation," but, on the contrary, the application of deflationary measures at a time when there was no serious inflation to justify them." From Hawtrey, "The credit deadlock," in, Gayer, (1937) p.132. The Hayekian view was that although prices might not have risen productivity gains

monetary gold.

It was only gradually and individually that currencies were stabilised. It has been said that this was a major fault. However, had countries not acted individually, and waited till conditions were ripe for an agreed overall return, the gold standard would probably never have been restored.

Austria (1922) and then Hungary were the first to stabilise with the assistance of League loans. It is interesting to note that as today it was held a central tenet of domestic stabilisation and the control of inflation that exchange rates be stabilised. The most marked difference being the greater degree of international co-operation and assistance evinced during the 1920s!

Montagu Norman was particularly involved in these efforts.[189] The French remained suspicious and jealous of Britain's efforts in this regard.[190] Germany followed in 1924, and it was not until March 1925 that the British Chancellor of the Exchequer, Winston Churchill, hesitantly took the plunge and restored the gold standard on the mistaken belief that US prices would continue to rise and, thus, close the gap between British and US price levels. Belgium stabilised in 1926 following a post-war experience of currency depreciation and instability which resembled the pattern followed in France.[191] Italy stabilised in December 1927.

Most of these stabilisation programmes were preceded and, or accompanied by deflationary policies, excepting those countries which had suffered hyper-inflation where it was not necessary to strike a balance between creditors and debtors.

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should have led to falling prices - hence Polanyi's (1957) perhaps sardonic reference to this period as one of "krypto-inflation."

[189] see various biographies of Montagu Norman.

[190] see Moreau's memoirs.

[191] P. van Zeeland in US Senate Gold and Silver Inquiry (1925), vol.1, pp.153-160, attributed Belgium's post-war currency inflation to the absorption by the *Banque Nationale de Belgique* of the marks issued during the German occupation. The belgas that were issued in replacement were meant to be backed by German recognition of ultimate liability for marks previously issued. As in the French case the exercise demonstrates faulty economic reasoning. The fact that the issue of belgas might be backed by an ultimate German liability in no guise reduced its inflationary impact nor given the uncertain nature of such an underlying asset did it prevent currency flight, i.e., a fall in the value of the currency once foreign exchange markets were re-opened. Unless economic agents could be induced to purchase a corresponding amount of Belgian government liabilities to finance the real transfer (viz., a current account deficit without a falling rate of exchange), but given the uncertain nature of the asset ultimately backing the currency issue this was not likely.

France reached *de facto* stabilisation in 1926 under Raymond Poincaré, at an undervalued rate. Sicsic's calculations (1992) suggest an undervaluation against sterling in 1927 of more than 25%, using retail price indices and using 1913 as a base year. Wolfe estimated an undervaluation against the dollar of 33% in 1926 and 15% in 1927.[192] Wolfe uses retail price indices and 1930 as a base. My own estimates suggest that the franc was undervalued by as much as 45% against sterling in 1926 and by 28% in 1927. And by 44.6% against the dollar in 1926 and 27% in 1927.[193] Though these are tentative estimates they leave no doubt that the French franc was very considerably undervalued.

Nevertheless, critics of the parity chosen failed to take into account domestic policy constraints. A lesser depreciation of the franc from its former *Germinal* gold parity would have imposed too great a burden on public finances, as it implied a higher real gold value on the outstanding public debt. Poincaré had been reluctant at first to envisage such a substantial devaluation,- an 80% devaluation from its pre-war gold par. However, he was eventually convinced that a higher gold value for the franc would have imposed too high a burden on the active "productive" sector of the economy,- as opposed to the "passive *rentier*."[194]

Eichengreen denies the view that the franc was deliberately undervalued, rather he argues that the stabilisation rate chosen marked a compromise between interest groups, viz., *rentiers*, producers, and exporters. Quoting Eichengreen, "There was little conscious manipulation of the exchange rates in the 1920s with the goal of promoting economic growth. Inflation and currency depreciation were unintended consequences of the fiscal war of attrition engaged in by rival interest groups."[195]

The new parity of the franc generated an accounting profit of over 17bn. francs on the Bank of France's revalued gold and other reserves, which conveniently eradicated the debt the French Treasury had incurred with the Bank of France,- a ready way of alleviating

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[192] Wolfe (1951) p.58, footnote 55.

[193] see tables in Appendix.

[194] Keynes (1923) argued that the solution to stabilisation in France and Italy lay in devaluing to a level at which, "the service of the internal debt is within the capacity of the taxpayer."(p.203). He argued that to return to pre-war parities in France would virtually, "triple the rentier's claims." *op.cit.*, p.72.

[195] see Golden Fetters, p.183. Keynes (1923) was of a similar opinion.

Treasury difficulties which would not be lost on subsequent governments.[196] Cancelling the debt involved what was essentially a book-keeping exercise. The currency itself, which was the counter-part to the Treasury's liability and the cause of the original depreciation, still remained in circulation.

Confidence in Poincaré's stabilisation was bolstered by a fiscal package, viz., halving the top marginal rate of income tax, increasing indirect taxation, as well as the creation of a *Caisse d'Amortissement* with its own ear-marked (hypothecated) revenue. The *Caisse* was charged with the task of gradually consolidating the floating debt to a two year maturity. This would make government paper more attractive. Reducing the floating debt would relieve the Treasury of the constant danger posed by a potential loss of confidence which would cause Treasury bill subscriptions to fall off and their immediate monetisation. Consolidation would thus increase Treasury control over the short-term money market. It also helped dissipate the fear which a forced conversion or moratorium had induced amongst investors.[197] These policies restored confidence and credibility and were bolstered politically by the cross-party coalition which Poincaré led.

Eichengreen places more emphasis on the political compromise which the advent of Poincaré represented, rather than the immediate fiscal measures. He argues that the budget was near balance and the revenue from the new taxes was minimal. He does concede, though, that the budgetary situation was only evident retrospectively and that before stabilisation prospects appeared bleak.[198] However, it is our view that the significant effect was due to Poincaré's being granted decree-making powers which signalled a break in the parliamentary impasse, albeit papering over differences, and the impact of the *Caisse d'Amortissement* which was charged with funding short-dated Treasury notes. Both measures helped relieve government of liquidity crises and put paid to threats of a forced conversion loan or capital levy.[199]

Underlying this shaky international monetary edifice there existed the legacy of inter-allied war debts, reparations and renewed protection, particularly on the part of new nation

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[196] see Sédillot (1953) p.279.

[197] see Goguel (1937).

[198] see Golden Fetters, p.183, footnote 75.

[199] see Golden Fetters, p.183.

states. France had also inherited a substantial war and reconstruction debt. The advantage of hyper-inflation in central Europe had been that it had effectively extinguished the internal debt.

The German economy recovered and managed to finance reparations liabilities, but only thanks to the inflow of capital in the form of investments in bonds which ensured that Germany's foreign exchange needs were met. Foreign direct investment would have proved a more flexible means of meeting the foreign exchange needs arising from reparations payments schedules and would have allowed for a more flexible stream of repayments. To effect the real transfer those states with reparations claims should also have increased their imports. The US in particular as the world's net creditor, which should have been at the forefront of this recycling process, sent the wrong signal through its introduction of tariffs in 1922.[200] Eichengreen points out that in many countries in the post-war world the use of foreign exchange reserves gained wide currency, except in the US which became the sink for the world's gold reserves.[201] Eichengreen estimates that by end 1920 the US held nearly 40% of global gold reserves.

The US did partly recycle its surplus, but this was on too short an account which made reparations flows too reliant on short-term capital inflows. As a result, when funds were drawn to speculate on Wall street and market sentiment altered in the wake of the October 1929 crash the febrile nature of the German payments situation became apparent. Eichengreen lays great stress on the extent to which the pattern of international settlements had come to rely on capital flows,[202] and particularly foreign lending by the US.[203] H.James (1992) has also emphasised the degree of reliance on short-term funds.

Although the follow-on conference of central bankers which had been called at Genoa did not materialise, during the period 1924-28 central bank co-operation between the US and UK occurred both in 1924 and in 1927. This consisted in the Federal Reserve Bank of New York reducing its discount rate on both occasions. However, Moggridge (1972) has pointed

[200] The Fordney-McCumber Tariff Act.

[201] see Golden Fetters, p.194.

[202] see Golden Fetters, p.122.

[203] Quoting Eichengreen (Golden Fetters), "The unstable equilibrium of the 1920s had set the stage for the collapse of the gold standard system. The pattern of multilateral settlements hinged on U.S. willingness to recycle its current account surpluses." p.285.

out this was also in the domestic economic interests of the US as domestic activity had slowed on both occasions. This co-operation, moreover, was conducted on a personal basis between Strong and Norman,[204] Norman and Schacht also consulted frequently on policy. However, relations between the Bank of France and the Bank of England were rather cold. This lack of co-operation arguably contributed to the mal-distribution of gold and the instability of the international monetary system. Eichengreen stresses the importance of personal relations in an international policy regime which lacked any institutionalised form of co-operation.[205] He argues that Benjamin Strong's untimely death impaired this as his successor, Harrison, neither enjoyed Strong's authority on the Federal Reserve Board nor entertained the same personal relations with Montagu Norman.

France perceived Britain's financial policy as being imperialistic and contrary to French foreign policy objectives,[206] which was to consolidate the *Little Entente* states viz., Czecho-Slovakia, Rumania and Yugoslavia to secure allies on Germany's Eastern frontier now that Russia had left the community of nations.[207] Support for Russia had been a corner-stone of French foreign policy before the First World War. Throughout the inter-war period France entertained close financial relations with Poland for similar foreign policy objectives. As a result friction developed between France and England over the stabilisation loans to, in particular, Rumania[208] and Poland,- although it had already started as early as the Austrian League loan. Paul Einzig characterised Montagu Norman's financial leadership, which so antagonised the French as determined by traditional balance of power politics and the necessity of reviving European trade,- which of course was in Britain's long run economic interest.

From 1926-7 the whole system began to unravel as France increasingly drew foreign exchange and gold as speculative funds were repatriated following stabilisation, and US

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[204] see Friedman & Schwartz (1963).

[205] see Golden Fetters, p.220.

[206] see Moreau's memoirs.

[207] The *Little Entente* had been formed, in part, as a diplomatic axis aimed at ensuring that any dispute over lands gained from Hungary as a result of the Trianon Treaty, after the First World War, would bring the involvement of all three states party to the *Entente*.

[208] see Moreau's memoirs.

capital outflows tarried. Hawtrey argued that the foreign exchange and gold inflow to France was precipitated by a desire on the part of economic agents to reconstitute real cash balances. As we have seen this explanation for the substantial capital inflow into France conforms to the monetary theory of the balance of payments model described by McCloskey & Zecher. In conformity with this model France began to run a surplus on current account during this period. However, to stem the effect of this inflow on the domestic money supply the Bank began to convert foreign exchange into gold. The Bank of Françe wanted the Bank of England to tighten credit conditions. Montagu Norman was loath to do so because of the prevailing domestic economic conditions. Instead the French authorities drew gold to try and force a tightening of credit conditions and avoid a pyramiding of speculative credit which led to inflationary fears. The French argued that the foreign exchange which they acquired and placed on deposit on the London money market had been on-lent and sold for francs so fuelling speculative inflows to France (though Drummond has disagreed with this description of events). These inflows were part prompted by the prospect of windfall speculative gains should the French franc be revalued nearer its former gold par.

The Federal Reserve Bank of New York agreed to supply gold to Paris at the London price in order to relieve pressure on sterling. French economists would later argue that this failure to act according to the tenets of the gold standard, viz., policy tightening in the UK,[209] accounted for the subsequent sterling devaluation and the boom and subsequent crash on Wall street. Eichengreen (Golden Fetters) does gives some credence to this

[209] Kooker in, Balance of Power or Hegemony (1976), reports the British counter-argument that to stem French gold inflows France should: adopt a cheap money policy; allow foreign issues in the Paris market; allow assets other than gold as currency backing and when the demand for cash had been stabilised foreign lending should pickup; that Paris should encourage a more active acceptance and discount market; that the Bank of France should discount UK commercial bills for French banks. The latter was hardly likely both because of the currency exposure that it would involve, and because of regulatory problems and information costs. And finally borrowing by HMG or credits to be extended to the Bank of England. However, none of these options appear very credible given the French *critique* of British monetary policy and financial imperialism. Unless, of course, sterling and the franc were seen to hang together. Mouré (1991) does mention, though, that Moreau was keen to develop the Paris money and acceptance market, but had felt thwarted in this endeavour. Mouré argues that this was a reason for his resignation. Kooker reports that during these conversations Leith-Ross had completely discounted a rise in UK bank rate as a remedy on the grounds that it would be synonymous with, "decapitation as a cure for toothache." (Kooker, op.cit., p.107, source cited: P.R.O., file T160 F12317/ 1-3, "Conversations with France on financial relations.")

view.[210] The predominant French view during the inter-war years was that the monetary co-operation that did take place, particularly in 1924 and 1927, was misplaced and was largely responsible for the eventual collapse of the international monetary system. This is the absolute converse of Kindleberger's thesis.

Hawtrey argued that the Bank of France should have expanded domestic liquidity in response to these inflows which had been prompted by a desire for higher real cash balances. In the event a gold deluge towards France developed during the period 1928-32. Sterling devaluation, in September 1931, would further reduce free international liquidity as France and other central banks divested themselves of foreign exchange holdings.

Another destabilising factor in 1928 was the flow of short-term funds which were withdrawn from Germany to be invested in the US stock-market. This revealed the precarious nature of the German and central European recovery and vindicated Schacht (1955) in his belief that this foreign lending had merely masked the real problem which was reparations and war debts. The capital inflows had effectively converted inter-governmental liabilities into liabilities to private bond holders, something which the Germans had always wished to avoid as it would make it all the harder to re-negotiate the principal due.[211] With the Young Plan they effectively accepted this principle.

The downturn in US economic activity which preceded the stock market crash, the crash, and the mounting US bank failures and fall in the money supply, and subsequent growing depression increased the instability of the system by spreading deflation across the exchanges.[212] In addition to this US lending fell and US capital was repatriated. France failed during the inter-war years to re-cycle its surplus, unlike its practice in the pre-war years, and both countries sterilised gold inflows.[213]

Friedman in his foreword to the English translation of Moreau's memoirs (1991)

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[210] see also Eichengreen (1990) "International monetary instability between the wars: structural flaws or misguided policies?", "In principle, the dual nature of reserves under the gold exchange standard could create problems of stability by relaxing the external constraint on the reserve-currency countries. These countries had no need to adjust to reserve losses, because they could finance them by providing domestic assets to foreign central banks, who happily accumulated them as reserves. There would no pressure to restore external balance."p.100.

[211] see Schacht (1955).

[212] see Friedman & Schwartz (1963); and in particular Eichengreen Golden Fetters.

[213] see Friedman's "Foreword" to Moreau's (1991) memoirs.

argues that had he fully understood the impact of French gold sterilisation he, and Anna Schwartz, would have attributed a substantial role in the spread of the depression to not only to the US but also to French monetary policy.[214] Of course, once the gold standard was suspended gold maldistribution became less of a problem as the domestic monetary base either became independent from gold reserve flows or devaluation against gold permitted a large currency expansion. One should note though that gold would still retain an important function as an official means of settlement between central banks. In fact it was the gold exchange standard that was brought down, gold still retained some of its original functions.

One should note a particularly perverse aspect of US monetary legislation. This stemmed from the so-called "free gold problem." The Fed. could only hold gold and eligible bills against its note liabilities. However, as economic activity declined so did the number of "real bills", as a result for any given note circulation the actual required gold reserve ratio

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[214] Quoting Milton Friedman (1991) in foreword to Moreau's memoirs, "Rereading the memoirs...has impressed me with important subtleties that I missed when I read the memoirs in a language not my own and in which I am far from completely fluent. Had I fully appreciated those subtleties when Anna Schwartz and I were writing our A Monetary History of the United States, we would likely have assessed responsibility for the international character of the Great Depression somewhat differently. We attributed responsibility for the initiation of a worldwide contraction to the United States, and I would not alter that judgment now. However, we also remarked, "The international effects were severe and the transmission rapid, not only because the gold-exchange standard had rendered the international financial system more vulnerable to disturbances, but also because the United States did not follow the gold-standard rules." Were I writing that sentence today, I would say "because the United States and France did not follow the gold-standard rules." (p.XII).

An early development of this thesis, which is congruent with that expounded by Hawtrey and Friedman & Schwartz, is that of Noble in, Gayer ed., (1937), "This experience seems to justify the belief that the depression was due mainly to misguided financial policies, particularly on the part of those financially powerful countries that controlled the gold supply of the world, i.e., Great Britain, France and the United States. Of these we must largely absolve Great Britain from blame."(pp.126-127).

Friedman goes on to state, "Strong and Moreau tried to reconcile two ultimately incompatible objectives: fixed exchange rates and internal price stability. Thanks to the level at which Britain returned to gold in 1925, the U.S. dollar was undervalued, and thanks to the level at which France returned to gold at the end of 1926, so was the French franc. Both countries as a result experienced substantial gold inflows. Gold-standard rules called for letting the stock of money rise in response to the gold inflows and for price inflation in the U.S. and France, and deflation in Britain, to end the over- and under- valuations. But both Strong and Moreau were determined to prevent inflation and accordingly both sterilized the gold inflows, preventing them from providing the required increase in the quantity of money. The result was to drain the other central banks of the world of their gold reserves, so that they became excessively vulnerable to reserve drains. France's contribution to this process was I now realize, much greater than we treated it as being in our History."(*loc.cit.*, *ibid.*).

This view is not necessarily incompatible with the Dick & Floyd hypothesis. In the latter if one assumes that the only means for the private sector to reconstitute its cash balances was to sell gold to the central bank (as was the case in France following the stabilisation law of 1928) and if this demand for cash balances were prompted by the mere fact of stabilisation and differing reserve ratio criteria applying to central banks, clearly this would have a disruptive effect, i.e., that the currency demand did not revolve around a putative savings/investment gap, but given nominal price inflexibility, the only way that the domestic money supply could be replenished was by effectively diminishing the monetary base (gold reserve) of, e.g., the UK.

would rise, effectively sterilising US gold reserves and reducing the level of world base money.[215] Eichengreen also notes that Federal Reserve banks which disposed of surplus "free gold" were reluctant to loan it out as it would reduce their autonomy, thus further diminishing the amount of "free gold."[216] One should note that adherence to a real bills doctrine implies a pro-cyclical monetary policy, whilst the monetarist model prescribes a contra-cyclical policy.

A.H.Meltzer (1976) has placed part of the blame for the US monetary contraction and failure to act on the real bills doctrine which informed the Federal Reserve's decision making. By which he means that low nominal interest rates were taken to indicate that demand for credit, or the demand for real bills discount, was low and that there was therefore no need to supply the market with additional currency which would only be redundant. This view also informed most of the French policy-making establishment and, in particular, the Bank of France.[217] Meltzer argues that this view expressed a failure to distinguish between nominal and real variables (q.v., Gibson's paradox) and that the return on real balances and short-dated securities was actually rising during the depression.

By 1930 the unstable equilibrium in Central and Eastern Europe had become untenable and with the collapse of the Austrian Credit Anstalt (a Rothschild bank), the Central European financial system began to collapse and came to a standstill, only to be revived under the economic, financial, and political leadership of Germany under a system of bilateral clearing agreements and blocked accounts.[218]

Following the collapse of the Credit Anstalt, the German banking system came under pressure and was closed under the pretence of a series of bank holidays. Eichengreen (Golden Fetters) adheres to the traditional view of the spread of financial crisis throughout Europe, and the world at large, which relies on the impact of the withdrawal of funds, frozen

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[215] see Friedman & Schwartz (1963); Rothbard (1983); and Eichengreen Golden Fetters, pp.194-195.

[216] see Golden Fetters, p.316.

[217] see chapter ten on the open-market policy debate.

[218] see Hirschman (1945).

deposits, debt default and uncertainty compounded by lack of sufficient co-operation.[219]

However, H.James, in a recent article, has taken issue with what he characterizes as: "above all a monetary history."[220] James argues that there did not exist the sort of linkages between the Austrian and German financial systems which could explain their collapse. Rather than ascribe the spread of crisis to capital flows, James (1992) argues that: "Bank crises were responses to general macroeconomic conditions. The world wide price decline for many commodities after the mid 1920s affected financial institutions because it reduced the value of banks' collateral. In this case, the primary origins of depression lie outside the financial sector." James argues that the failure of the Credit Anstalt undermined confidence in the Austrian economy because it was in practice a holding company for it, but more importantly he argues that its significance lies in its budgetary implication for Austria. And he argues that this experience of banking crisis and budget deficit was replicated in Hungary.

Eichengreen (Golden Fetters) mentions James' *critique* of his financial flows explanation for the spread of financial crisis throughout Europe, but retorts that the fact that Austria and Hungary introduced exchange controls acted as a warning light and caused a capital outflow from Germany. Germany would also introduce exchange controls. It is interesting to note that policy action by the central European states was part dictated by historical experience, viz., the post-war hyper-inflation.[221] Eichengreen also attributes the German crisis to the Nazis' electoral results and the crisis in the banking sector with which industry was closely intertwined.

Eichengreen uses Germany as an illustration of the destabilising transmission mechanism imposed by the fixed exchanges and the policy dilemma with which this

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[219] Quoting Eichengreen (Golden Fetters), "Thus, financial links running from New York to Latin America and Central Europe and from there to London transmitted the destabilizing impulses that brought down the gold standard system. Such impulses were ordinarily contained by the credibility of the commitment to gold and international cooperation. But by 1931 the gold standard's credibility was increasingly questioned. The influence of domestic pressure groups raised doubts that maintenance of the gold standard would be valued above other objectives. The deepening Depression raised the costs of permitting liquidation to run its course. The doubts prompted by these developments attenuated the stabilizing influence of the market, placing a growing burden on central banks and heightening the importance of international cooperation."p.285. The necessary cooperation did not materialise.

[220] see H.James (1992) p.594.

[221] see Golden Fetters, p.270.

confronted the authorities,[222] for as gold losses increased the Reichsbank had to rely on loans from the Bank of England to maintain its minimum reserve ratio. The obligation to maintain this ratio prevented the Reichsbank from discounting paper for the commercial banks as this would increase the central bank's liabilities, as a result banks had to suspend payments. Only exchange controls could insulate the domestic monetary system from the constraints imposed by international flows and lend the domestic authorities some degree of autonomy. Eichengreen blames the German crisis on a lack of international co-operation. The US could only extend a loan if Germany tightened credit, which was contrary to the purpose for which the loan was sought, viz., to relax credit conditions. France, for its part, insisted that Germany abandon its proposed customs union with Austria and the construction of pocket-battleships, and argued that Germany was playing up the crisis to obtain concessions on reparations.[223] This illustrates well Eichengreen's point that considerations other than financial ones intruded on monetary co-operation. Eichengreen's opinion is that only concessions on reparations would have assisted Germany, otherwise any funds lent would only end up in France.[224]

Pressure on London followed, particularly after the publication of the Macmillan Report which revealed that a substantial proportion of assets were immobilised in Germany. James (1992) attempts to further substantiate his thesis by arguing that the budgetary issue in the UK was at the forefront of political debate before the German financial crisis broke and that the recommendation in the Macmillan committee report in favour of stemming the downturn in prices was considered inflationary and that this caused capital flight and a fall in reserves. However, in the case of the UK there was no threat to the commercial banking system nor was the crisis linked to public sector debt overhang, rather the political costs of maintaining the fixed exchange rate commitment (viz., continued deflation or reductions in public expenditure) were such that credibility was severely impaired, whilst fear caused by the publicity given to frozen balances held in Germany with the publication of the Macmillan Committee report cast doubt on the liquidity of the financial system.

It is interesting to explore the contrary views espoused by Eichengreen and James.

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[222] Golden Fetters, p.274.

[223] see Golden Fetters, p.276.

[224] see Golden Fetters, pp.276-278.

James argues that the prime cause of depression lay in real factors, viz., the fall in primary commodity prices and increased public indebtedness due to the war.[225] Rather than place the emphasis for the spread of depression on deflationary pressures emanating from the US spreading across the fixed exchanges, as Eichengreen (Golden Fetters) does, James argues that the gold standard failed to work smoothly as budget deficits and the substantial burden of indebtedness impaired credibility. James places emphasis on the extent of short-term debt as a result of which a crisis could arise if the market took the view that debt renewal would be difficult, precipitating treasury difficulties and consequential monetisation of short-dated Treasury paper.

Quoting James, "An explanation of the increased vulnerability of finance to politics lies in the overall expansion of public debt relative to the prewar era. One dramatic difference between the pre- and postwar world was the extent to which debt structures were dominated by public sector liabilities."[226] James adds that, "The fiscal response to depression proved to be a major source of financial instability, which in turn intensified the depression."[227] However, none of this invalidates Eichengreen's thesis and nor does the issue of financial flows between Austria and Germany. Reserve flows between the US, UK, and France and between the Gold Bloc states were very substantial[228] and deflationary pressures across the exchanges need not be immediately felt by means of actual reserve flows, international price arbitrage would be enough.[229]

In the case of central Europe it was well known how precarious Germany's balance of payments situation was (q.v., Schacht's memoirs) and the collapse of the main Austrian bank would be enough to prompt a healthy re-appraisal of the credit worthiness of Germany. It seems that neither thesis invalidates the other, rather they complement one another. Later James seems to squarely embrace Eichengreen's thesis when he states that, "...withdrawals

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[225] One should note that at no point does Eichengreen argue that monetary factors were the sole initiating factors, if at all, rather the monetary contraction compounded the depression. This is also the opinion of Friedman & Schwartz (1963) whose interpretation of the initiating causes of the depression is far from being mono-causal.

[226] see H.James (1992) p.608.

[227] H.James (1992) p.598.

[228] see chapters 6, 8, and 9 of this thesis.

[229] see McCloskey & Zecher (1984).

across the exchange posed a double threat, to internal financial stability and to gold standard maintenance."[230] He argues that in case of banking crisis and capital flight providing liquidity to the domestic banking system, as in Hungary, might just supply ammunition for speculators to sell on the foreign exchange market. A debt standstill, as negotiated with Hungary, would provide only temporary relief. He argues that a suspension of gold convertibility was the best solution to stem speculative flight as it would add currency uncertainty, by implication suggesting the possibility that a currency could later appreciate, thus lending support to the currency. However, this seems rather spurious as there could only be one direction in which a currency could be heading in such circumstances, viz., southwards. Rather the point, as so cogently made by Eichengreen (Golden Fetters), is that by removing the exchange rate constraint the authorities acquired the ability to act to stem the domestic banking crisis without the prospect of the central bank losing all its reserves whilst facing a concomitant run on short-dated Treasury bills.

James goes on to characterize inter-war financial crisis in the following way, "Uncertainty about public budgets thus played a central role in undermining the stability of the interwar financial system. During the depression, a vicious circle had emerged, linking budget deficits to assessments of exchange rate stability, the resulting capital flows to withdrawals of deposits from banks, and subsequent bank failures and crises in turn to budget problems."[231] In this context it is important to note that in France the capital outflow was not so much linked to a run on commercial deposits, but its significance lay in a failure to renew short-dated Treasury bills (viz., a run on the state), this caused acute treasury problems and monetisation which further fuelled speculation against the currency.

James rests his thesis on the fact that the experience he describes above was not confined to countries which had experienced inflation or hyper-inflation,- arguing that an explanation which does not rely on the political culture (as adduced by Eichengreen in Golden Fetters), should be sought. It is his thesis that this is to be found in the budget difficulties confronting states and the implication for government budgets of financial crises. He argues that in France during the stabilization period of 1926-31 conditions were stable

[230] H.James (1992) p.600.

[231] H.James (1992) p.607.

because, "of the reduced claims made by the public sector."[232] However, the most salient feature of the stabilisation was the ability of Poincaré to set up a debt amortisation agency which enjoyed hypothecated revenues, this put paid to the threat of a capital levy, and along with the pegged exchange rate allowed the *Caisse d'Amortissement* to gradually lengthen the maturity of the short-dated unfunded debt which had been the bane of governments over the period 1922-26. One should also note with reference to James' thesis that the budgetary difficulties of governments were intrinsically linked to perverse macro-economic policies which resulted from the authorities' attempt to maintain the credibility of the gold fixed exchange rate. This is the essence of Eichengreen's thesis, and is well borne out by my own research. As such James' thesis is static and does not take account of the dynamic and perverse interaction between exchange rate policy, budget deficits, and perverse policy reactions which greatly exacerbated government budgetary difficulties (q.v., the British case).

Sterling was devalued by the National Government in September 1931 following the break-up of the Labour government on the question of reductions in unemployment benefits. This had followed the publication of the May committee report which had recommended a 20% (!) reduction in unemployment benefits, an instance of how controversy surrounding domestic economic and political measures impinged on the credibility of the fixed exchange rate commitment. A 10% cut was eventually implemented.[233]

Confidence in sterling had been further shaken by the so-called Invergordon mutiny. This was a short-lived strike by naval ratings against wage cuts. However, coming just a few years after the revolt of the Russian Baltic fleet at Kronstadt, it was not without causing some disquiet. One should note that as a result the First Lord of the Admiralty, Sir Austen Chamberlain, recalled the Atlantic fleet. Reductions in public service pay were eventually set at 10%, partly as a result of such dissatisfaction. Originally 15% cuts had been rumoured.[234] Devaluation came despite loans proffered by the Bank of France and the Federal Reserve Bank of New York. Thereafter international liquidity contracted as central banks ran down their foreign exchange balances. The Bank of France had incurred

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[232] H.James (1992) p.609.

[233] Rueff (1931) argued that high unemployment in the UK was in part due to rising real unemployment benefits, as the price level fell, and wages came under downward pressure. A substantial literature has built-up in this field in recent years.

[234] see Keesing's.

substantial losses on its sterling balances. Eichengreen provides estimates of the net reduction in international reserves which resulted of between $93-105 million in the period end 1931 to end 1932.[235] His principal source is Nurkse (1944). But his figures are an underestimate of world monetary base contraction as newly acquired gold reserves were increasingly sterilised by the Bank of France and the Federal Reserve.[236]

By 1931/32 with the Hoover moratorium and the Standstill agreements on commercial debts and the Lausanne agreement which effectively ended the unfortunate episode of war debts and reparations,- though it was never ratified as it was contingent upon the US giving up its claims to war debts,- we enter a period marked by an increased divergence of views over the objectives of monetary policy and the role of the state, *vis-à-vis* the economy.[237] This shift is clearly denoted in the monetary declaration of the Ottawa Conference of Commonwealth countries in 1932, which stressed the necessity of raising prices.[238] It also witnessed the beginning of the period of Empire Preference and the Sterling Area, and managed currency with the creation of the Exchange Equalisation Account. Sterling devaluation had the advantage of not turning the terms of trade against Britain as so many of the world's commodities were invoiced in sterling, a distinction which French policy-makers would make in the context of a proposed French devaluation. Within the embryonic sterling area liquidity increased as sterling balances began to be held again and gold was dishoarded from India and South Africa.

Quoting Eichengreen, "Stabilizing against sterling minimized the risk of holding foreign exchange reserves in London. From 37 per cent of total reserves at the end of 1931, the share of foreign exchange in the reserves of fifteen sterling area countries rose to 51 per cent by the end of 1933. The solidification of the sterling area thus helped to reverse the

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[235] see Golden Fetters, p.291, footnote 5.

[236] see also Eichengreen, "Did international forces cause the Great Depression?" (1988), who provides the following figures for the decline in foreign exchange reserves, "Between 1928 and 1932, the share of foreign exchange in the reserves of 24 European countries fell from 42 to 8 per cent." And, "The value of foreign exchange reserves of the 24 European countries fell from $2,520 million in 1928 to $505 million in 1932. Most of this decline took place between the end of 1930 and the end of 1931."(op.cit., p.108). Though he admits that this was not solely due to French behaviour. Excluding France, in 23 countries, foreign exchange as a percentage of reserves fell from 36% to 11% in the period 1928 to 1931.

[237] see Golden Fetters where Eichengreen contrasts the post Second World War world when a Keynesian consensus largely prevailed till the early 1970s.

[238] see text in Pasvolsky (1933).

liquidation of exchange reserves experienced in preceding years."[239] Gold production also picked up after the South African devaluation in 1933, as domestic gold production became more profitable.

The increasing dissent over monetary policy objectives came to a head at the World Economic Conference held in London in 1933. The Conference had been agreed at Lausanne. The US refused to participate at the Lausanne conference to avoid a linkage between reparations and war debts. They agreed to participate in the London conference to discuss means of stabilising commodity prices though it was clear that currency questions would head the agenda.[240] These were of course linked. However, attempts at securing a currency stabilisation agreement between the French, US and UK did not materialise which meant that the Conference was effectively still-born. A currency agreement failed, principally because Roosevelt did not wish to compromise his internal recovery programme which was premised on raising internal prices. Increasing the dollar price of gold, or depreciating the dollar, was the means chosen to achieve his goal.

McCloskey & Zecher (1984) attribute the significant rise in commodity prices in 1933-34 to this policy. They distinguish their own analysis from Friedman & Schwartz's which they characterise as attributing the rise to a loosening of monetary policy, Friedman has argued that this distinction is somewhat contrived.[241]

A trade truce proposed by Cordell Hull was not much success either. The Conference was a failure, but it did make certain recommendations in the monetary field. It urged that a maximum 25% reserves be held against currency issue, following the recommendation made by the League of Nations Gold Delegation in its report published in 1932. This was implicitly directed at France which had a legal 35% reserve requirement, but a far higher effective reserve ratio. Cassel, Strakosch, and Hawtrey argued that France had contributed to deflating the world price level by absorbing so much gold. It was hoped that a relaxation of gold reserve ratios would relieve the liquidity problem and help reflate the world economy.

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[239] see Golden Fetters, p.338.

[240] see Traynor (1949).

[241] see Bordo & Schwartz (1984), article by McCloskey & Zecher and comment by Friedman - the McCloskey & Zecher argument implies that the US was a price-taker.

However, French policy-makers argued that they could not act on the demand for credit and could not inject liquidity in the monetary system because the Bank of France was not empowered to conduct open-market operations.[242] And by implication even if the Bank of France had been regulated by a lower reserve ratio it would not have been able to make it effective. Governor Moret of the Bank of France argued that even if the Bank were entitled to conduct such operations it would have little effect on the money market as credit played a relatively subsidiary role in the French monetary system.[243] Further hampering any open-market operations was the fact that the French money market was not centralised around a discount market as the London market was.

It was not quite true though that the Bank of France could not conduct open-market operations. It effectively did so by buying bills on account of foreign central banks.[244] This facility was granted the Bank by the law of 25/6/28. However, as Laufenberger (1940) argued the Bank only played a passive role in this regard as it had no control over the level of funds deposited by foreign central banks which it could use to invest in short-dated government paper. However, the Bank was allowed to sell the 5,930 million francs worth of *bons de la Caisse d'Amortissement* which it had received in compensation for losses incurred on loans which the government had encouraged it to make to Russia during the First World War.[245] Sandoz (1936) argued that during discussion of the monetary law of 1928 open-market policies did get some support which is why the facility to market these *bons* was granted the Bank of France. Mouré (1991) argues that Moreau, the Governor of the Bank of France, had lobbied for such facilities to develop the money market and help Paris become a financial centre.

Following sterling's devaluation, in September 1931, the Bank incurred further losses,

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[242] see Eichengreen & Wyplocz (1986).

[243] see chapter 10; and documentary Appendix.

[244] see Mouré (1991). And quoting Eichengreen (Golden Fetters), "Correctly or not, French politicians blamed the 1922-26 inflation on deficit spending financed by money creation. The 1928 stabilization law was designed to insulate the Bank of France from pressure to again monetize government budget deficits. Authorization to use open market operations was limited to three circumstances. First, the Bank of France was permitted to repurchase 90-day bonds of the Treasury's newly created debt management agency (the *Caisse d'Amortissement*) which it had previously assisted in placing on the market. Second, the Bank was empowered to purchase bills and short-term securities on behalf of foreign banks of issue that maintained current accounts with it. Third, it was permitted certain dealings in foreign exchange."p.196.

[245] see Servais (1938); and documentary Appendix.

this time on its on sterling balances, of some £62 millions sterling.[246] Again the Bank was offered *bons* of the *Caisse d'Amortissement* which it could market. These amounted to 2,342 million francs.[247] It is interesting to note that in both cases the Bank was first given a Treasury bill to the estimated value of the losses incurred, the Bank surrendered this to the *Caisse* which in turn delivered negotiable bills on the *Caisse* which were carried on the asset side of the Bank's balance-sheet. For the government it reduced its liability to the Bank and may be considered a form of off-balance-sheet-accounting. There were provisions to gradually amortise these balances.[248] However, the bills offered in compensation did not carry a coupon and bore no-interest. Sandoz (1936) argued that this was a probable reason the Bank did not market them, as it would have had to sell them at a discount. The discount would also have to take account of the fact that the bills would be liable for an 18% tax schedule as well as the 2% turnover tax all of which would eat into Bank profits and assets.

However, Mouré rejects the proposition that the lack of coupon on those bills was the reason that the Bank failed to market them,[249] rather he blames opposition from certain regents of the Bank of France.[250] Mouré's source is Netter's unpublished history of the Bank of France. Mouré suggests that one reason Moreau would not have minded selling the bonds at a discount to face value is that this would have been offset by the potential loss of revenue on income earned on advances on securities' collateral (*avances sur titres*) which would arise if interest rates were to fall as a result of excess market liquidity. According to Mouré it was the opposition of the regents of the Bank of France to managed money which precluded this operation, although Mouré does add that they had approved, in principle, the

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[246] see Servais (1938).

[247] see Sandoz (1936).

[248] see chapter ten for a detailed account of the balances outstanding.

[249] Mouré (1991) pp.139-140.

[250] Moret, Governor of the Bank of France from 1930-1935, argued that such operations would be inflationary. In this context Eichengreen notes that, "Different experiences with inflation during and after the war bequeathed competing conceptual frameworks that impeded efforts to agree on a common response to international monetary problems."(Golden Fetters, p.392). Additionally the prevailing opinion in France was that such operations which aimed at insulating the domestic monetary system from the effects of movements in the balance of payments induced by real factors were fundamentally flawed and would not be able to forestall adjustment forever. This is very much Hayek's view (1937) and that of the global monetarists (q.v., McKinnon).

sale of FRF 2.5bn.[251] However, more to the point, open-market sales would have reduced the money supply and if Hawtrey's thesis is correct, that the gold inflow resulted from an increased demand for cash balances following stabilisation which could only be satisfied,- given the new statutes of the Bank of France,- by the exchange of gold for notes at the central bank, the sale of bonds would be offset by a compensatory gold inflow. What is more given the Bank's argument that the gold exchange standard was destabilising and helped fuel the upward speculative pressure on the franc in the period July 1926 to June 1928, it was hardly likely that the Bank would engage in open-market operations. The French policy-making establishment and particularly the Bank of France considered these to be one of the principal policies which had allowed countries to escape the strictures of the gold standard by allowing the monetary authorities to sterilise the effects of gold reserve flows on the domestic monetary base. French policy-makers considered the gold exchange standard and open-market operations as necessary complements. Both were synonymous in their eyes with "*la monnaie dirigée*". Clément Moret, Governor of the Bank of France 1930-35, was particularly attached to this prejudice.

It might argued that the Bank could have purchased sterling bills and exchange forcing the franc to its gold export point. Thus redistributing gold and increasing the domestic money supply, but this would have been a highly dangerous strategy if the Bank was perceived as actively engaging in such operations, rather than passively buying foreign exchange to maintain the fixed exchange rate peg against sterling which lasted until formal stabilisation on gold in June 1928.

After 1928 the Bank was precluded from increasing its foreign exchange portfolio over and above the level prevailing at stabilisation. Furthermore, following the devaluation of sterling there was no prospect that the Bank would again maintain a substantial foreign exchange exposure.

As Eichengreen (1985) argued in the context of the debate over open-market operations and sterilisation of gold inflows the point is not so much whether the Bank enjoyed this facility, but rather that it had never marketed them and therefore could not act to expand the volume of credit through purchase of these bills. Conversely sales of bonds by the Bank might have been justified after 1926 to reduce the impact on the money supply

[251] see also Eichengreen Golden Fetters, p.197, who adds that FRF 2.5bn. only amounted to 1.7% of M1.

of foreign inflows (sterilised foreign exchange intervention) and been an alternative to selling foreign exchange for gold in order to tighten money market conditions abroad. However, as we have seen above such a policy would probably have proved counter-productive, particularly if it raised domestic interest rates and thereby prompted further capital inflows which, given the fixed currency peg, would automatically expand the domestic note circulation.

Aside from open-market policies if the Bank had intervened by selling foreign exchange to reduce the domestic money supply this would have depressed the foreign currency to its gold export point to Paris (raise the franc to its gold import point against that currency) and the resulting gold inflow (gold/currency arbitrage) would offset any monetary tightening resulting from currency intervention,[252] i.e., sterilisation would be ineffective.

Open-market operations were not officially permitted in France until 1938.

The London World Economic Conference proved a total failure as the US decided to unilaterally devalue, being more concerned with domestic reflation than with any currency agreement,- a natural reaction for a country which was so little dependent on foreign trade.[253] This policy was roundly condemned by the French who formed a Gold Bloc comprising Holland, Switzerland, Italy, Belgium, Luxembourg and Poland, and eventually Lithuania.[254] Some scholars have included Czecho-Slovakia and Danzig in the Gold Bloc, but this is a frequent misapprehension due to the fact that both states remained on gold. However, neither was a party to any of the formal agreements between Gold Bloc members states.[255] The Gold Bloc member states argued that it was first necessary to stabilise exchange rates, bring back confidence, foreign lending and trade, and that then a world rise in prices would ensue. The sterling area and particularly the US held that prices should first be raised and then stabilisation considered. It is paradoxical though that the UK abandoned gold because its price level was too high, whilst the US left it to raise its price level. The French referred to Roosevelt's policy as attempting to establish an, *étalon marchandise*, or,

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[252] see Eichengreen Golden Fetters, p.197, footnote 19; and also chapter ten of this thesis.

[253] Eichengreen (Golden Fetters) shares this appreciation, "The conference was a complete and utter failure."p.317.

[254] Belgium and Luxembourg were already party to a currency union.

[255] Redmond, in Broadberry & Crafts (1992), places Danzig in the Gold Bloc (see footnote 38).

a commodity standard (see Irving Fisher).

Eichengreen (Golden Fetters) has shown that Roosevelt was largely acting to deflect reflationary pressure in Congress when he adopted the Thomas Amendment to the Agricultural Adjustment Act which empowered him to depreciate the gold value of the dollar. Eichengreen's work is welcome as it demonstrates clearly the domestic pressures confronting Roosevelt and the policy dilemma which he faced, either to maintain the fixed exchange parity or suspend gold convertibility which would give the President autonomy to act on the domestic front.[256] However, what most attracted Roosevelt to steady dollar depreciation was the correlation between dollar depreciation and the rise in stock and commodity prices. Eichengreen (Golden Fetters) argues that Roosevelt was influenced by G.Warren & F.Pearson (1935) who published a book entitled Gold and Prices.

A word perhaps on the sterling area. UK policy was very much that of an N-1 currency, the previous lack of which, arguably, was what had been missing. That is the UK refused to enter into any exchange commitments with sterling area countries which comprised most of the Empire and Scandinavian countries, and Egypt (etc.), except for Canada which since 1929 floated, against an equally weighted sterling/dollar basket. The UK policy was to allow these countries to peg their currencies against sterling and to give them preferential access to the London capital market. The London capital market had always been policed by the Bank of England,- particularly in the period before the resumption of gold specie payments in 1925,- again belying the text-book view of the gold standard's pure automaticity. This unwillingness to commit the Government to a fixed rate for sterling would contribute to the precarious nature of the Tripartite agreement and along with the French suspension of specie payments explains the subsequent 24 hour gold exchange guarantee. The 24hr. gold guarantee ensured short-term (gold) cover for any intervention conducted in foreign exchange, as part of the UK's managed float. Drummond (1981) argues that the sterling area held together because of the UK commitment to cheap money which avoided deflationary pressure, and the access which it afforded to the London capital market.

As for the Gold Bloc it consisted merely of an agreement to keep respective currencies pegged to gold and failed to produce any substantial preferential trade agreement. From its very inception the Gold Bloc had been under strain. It was set up as a defensive

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[256] Without suspending gold convertibility the choice would have been between a banking collapse or balance of payments crisis, viz., run on the dollar.

currency pact to stem speculative pressure against the Dutch guilder and Swiss franc which had built-up when it had become apparent that the World Economic Conference would fail.

Following Roosevelt's gradual debasement of the currency by means of gold and silver purchases US activity began to revive. However, the dollar depreciation, coming as it did after several years of deflation placed an additional burden on those countries which had remained on gold. Quoting Eichengreen, "The United States was the principal source of pressure on the international system and the gold bloc in particular. Gold and financial capital flowed inexorably towards the United States. American producers used their new found competitive advantage to expand exports to the gold bloc countries and crowd them out of third markets. Almost every country on gold suffered a trade deficit and a slow-but-steady depletion of its international reserves."[257]

The revival of activity permitted the US to increasingly encourage a policy of relative currency stabilisation with a $5 sterling parity as a goal. The pre-1931 "cable" had stood at $4.86.[258] The US and UK acquiesced to the French devaluation of 1936 under the guise of the Tripartite Monetary Agreement. According to some, this ushered in a period of increased monetary co-operation and marked, to some extent, the beginning of the US's financial hegemony as the dollar was the only major currency with a fixed gold price and willing to settle such balances in gold (on condition of reciprocal arrangements). Paradoxically despite the abandonment of gold, gold remained the only ultimately acceptable reserve asset.

Drummond (1979) does not accept the view that the Tripartite signified a major policy shift, as Moggridge has argued, on the grounds that it committed none of the parties to a particular exchange rate beyond a 24 hour guarantee. And that it was characterised by a gradual depreciation of sterling and the franc.[259] However, Drummond looks at the

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[257] see Golden Fetters, p.352.

[258] The "cable" is the name given to the sterling/dollar rate, so named because of the telegraph cable under the Atlantic. The dollar rate is still quoted in pounds sterling (*au certain*),- the vestigial remains of Britain's former financial supremacy.

[259] Quoting Drummond (1987), "Surveying these developments, one has trouble understanding why an earlier generation of scholars thought the declarations of September 1936 had actually stabilised exchange rates."(p.52). This myth has been a recurrent feature of the certainties which have governed the literature on the inter-war years, "Thus, the tripartite system assumed increasingly the character of a dollar standard, with the two other principal currencies aligned at more or less stable rates on the dollar."(Cleveland, in, Rowland, (1976), p.56). Nearer the truth is probably Rowland's judgment that, "Significantly, it was Britain who attached

Tripartite in terms of currency stability, the important point is that the US dollar was not competitively depreciated. Eichengreen argues that at least it entrenched the dollar gold price of $35 an ounce.[260] To my mind that such an accord was reached does indicate along with the US's **Reciprocal** (one should note) Trade Agreements Act (1934) a certain willingness to co-operate, if compared to the intransigence displayed by Roosevelt at the London conference. The rejection of the van Zeeland plan does indicate that this was very limited,- however, this six month currency stabilisation plan was proposed in 1938. The question as to whether the Tripartite was a success, or not, is a matter of emphasis. Nobody would dispute Drummond's claim that the Tripartite did not amount to much.

After France's devaluation and the break-up of the Gold Bloc, Belgium, the Netherlands, and Switzerland became party to the Tripartite Agreement. Italy and Poland,- both resorted to clearing agreements. Poland was increasingly drawn into the central European managed trading bloc centred on the Reichsmark. The French franc finally lost all prestige when in 1938 it was pegged at a minimum of 179 francs to the pound, thus becoming a virtual member of the sterling area.

CONCLUSION:

This chapter suggests eight major conclusions on the nature of the inter-war currency system. These are:

1) The altered nature of the pre-war standard which was now based on two and half financial centres rather than one. This increased the degree of capital flows which made the international monetary system more volatile. One should particularly stress the lack of

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the most stringent reservations to the Tripartite Agreement. British officials, for example, were responsible for the formula which would allow the Agreement to be abrogated on twenty-four hour's notice."(Rowland, in, Rowland, (1976), p.210). Skidelsky in his article in the same volume has grossly over-played the political leadership of the US within a democratic bloc facing the fascist states. Leith-Ross admitted that the Tripartite Agreement, as far as HMG was concerned, was only a face-saving exercise for the French government. Similarly, on the issue of trade liberalisation and the Anglo-American Trade Agreement of November 1938, surely one reason that this sort of initiative now became possible was that sterling now off gold and on a managed float, and the economy having picked up, deflation across the exchanges no longer presented the same threat? Skidelsky does make a good point which is that once the UK had devalued the need to honour its war debt to the US had become less pressing and the UK was declared in default in April 1934. One should note, though, that France had already defaulted and Germany was no longer honouring its obligations.

[260] see Golden Fetters.

institutionalised co-operation between central banks.[261]

2) There was a failure to recognise that the pre-war gold standard had not functioned according to the price specie-flow mechanism and had relied significantly on co-operation; that sterling had lost its dominant role in the international monetary system, or at least that London's position as an international capital market had been severely undermined; and that the pre-war gold standard had not been characterised by automaticity.

3) Equilibrium via price adjustments had become more difficult. Deflation was more damaging in an environment characterised by the relative "fixity" of retail prices and wages, particularly given the extent of the shock.[262] It produced unemployment for which governments would increasingly be held accountable.[263] The fact that domestic politics intruded on international monetary policy and that the resulting budgetary stance had an impact on employment highlighted the question of the relative distribution of the fiscal burden which politicized the exchange rate commitment and economic policy to an extent which had been absent before the First World War.[264] This helped undermine credibility, e.g., in the UK in 1931 when the political costs of the fixed exchange rate commitment, in terms of the required budgetary retrenchment, appeared too onerous. The erosion of credibility meant that capital flows rather than be equilibrating would tend to be disequilibrating,[265] anticipating and thereby precipitating devaluation.

The disparity which was alleged to exist between wholesale "flex" prices and retail "fix" prices was a constant theme of inter-war literature. The British authorities, with the advantage of their experience in the 1920s, realised that it would be easier to devalue than to continue deflating. It was argued that this would raise (inflate) wholesale prices (q.v., Hawtrey) without the costs of attempting to deflate the nominal retail price level in line with

[261] see Eichengreen Golden Fetters.

[262] Supply-side inflexibility meant that adjustment was achieved through quantity shifts which had a negative impact on demand and prices thereby compounding the difficulties of supply-side adjustment.

[263] see Golden Fetters.

[264] see Golden Fetters.

[265] see Golden Fetters.

wholesale prices.[266]

4) The failure of the US as the world's largest creditor to lend contra-cyclically[267] and disappearance of the badly burned French *rentiers*, had removed a mechanism for recycling surpluses and international liquidity. The existence of several financial centres made for more volatile capital flows.

Orthodox budgetary policy and the lack of contra-cyclical stabilisers, such as significant welfare transfer payments (which today bolster private consumption), help explain the significant fall in economic activity in the 1930s.

5) The failure of France and the US to deal with war debts and reparations complicated international financial problems, as well as the US and the UK's unwillingness to comprehend the very real strategic and foreign policy preoccupations of France in the early 1920s which conditioned her behaviour. War debts and reparations soured international monetary relations and impaired co-operation and credibility.[268] Another significant legacy of the war was the inflated commodity prices which dropped precipitously after the war and which were weak throughout the inter-war period.[269]

6) Failure to react to the European financial crisis until it was too late. In the US action should have been taken to prop up the banking system.[270] The ensuing collapse of the credit and monetary system and fall in the US price level helped spread deflationary forces internationally. It is crucial to Eichengreen's thesis that the fixed exchange rate constrained the ability of the authorities to act domestically until the gold standard had been suspended.[271]

7) Currency depreciation and trade protection (beggar-my-neighbour policies) were

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[266] see Neville Chamberlain's opening speech at the London World Economic Conference,- extracts in documentary Appendix. Quoted in Pasvolsky (1933).

[267] see Kindleberger (1973).

[268] see Golden Fetters.

[269] see Timoshenko (1933).

[270] see Friedman & Schwartz (1963).

[271] see Golden Fetters.

not the cause of depression,[272] but rather defensive measures.[273] In this context it is important to note that Eichengreen's thesis, viz., that the depression was transmitted across the fixed exchanges, leads to opposite conclusions to those adduced by Nurkse and Cordell Hull, i.e., in the former case that speculative currency movements and in the latter exchange dumping and beggar-thy-neighbour policies were pre-eminent factors in the spread of depression, rather it suggests that currency depreciation, i.e., abandoning the fixed gold par, was precursor to the nationalisation of monetary policy, and by thus removing the deflationary impulses coming from across the exchanges, allowed a looser macro-economic stance and was a prelude to economic recovery.[274] Removing the gold peg, and or devaluing, reduced speculative capital flows. These flows had been precipitated by the perverse policies which increasingly over-valued fixed gold parities imposed. Foreign exchange markets took the view that ultimately if governments had to choose between the fixed gold parity and domestic stability they would choose the latter. It was not "speculative" capital flows that were destabilising, but fixed gold parities. Paradoxically, breaking the "golden fetters" helped restore credibility, but only when buttressed by sound economic policies and political stability. However, both would be wanting in France following the Blum devaluation. In this case rupturing the golden anchor invited a rake's progress which the financially orthodox had always predicted.

Eichengreen argues that in the absence of co-operation, which was precluded by different conceptual models owing to distinct post-war monetary experiences, and the asymmetric balance of payments adjustment mechanism, devaluation and or suspension of the gold standard was the only way out of depression. However, Eichengreen ends by making a plea for co-operation in the monetary field, arguing that a system built around a

[272] This is already recognised in a Chatham House study of inter-war unemployment, "A main preoccupation with many countries, especially with those still on gold, or nominally on gold, has been to avoid an adverse balance of payments. The gold standard system, in normal times, provided a simple means of regulating the balance of trade; in the absence of means of adjustment every kind of device has been adopted to maintain an even balance, by import prohibitions, quotas, the rationing of foreign exchange, and resort to barter. These methods are accompanied by general unemployment and poverty, but it may be argued that in their extreme form they are a result and not a cause of high unemployment." From, Unemployment an International Problem,(1935) p.186.

[273] see also Eichengreen Golden Fetters.

[274] An early exposition of this view is the following, "It required the breakdown of the gold standard in all countries to usher in recovery." Noble, in, Gayer ed., (1937), pp.126-127.

single hegemon will reflect its own interests and when that nation's relative power declines the regime/system will not be endowed with the mechanisms to cope.[275] This conclusion which is redolent of David's Calleo's (1976) analysis and is idealist in conception seems faulty, and rather contradicts much of the tenor of Eichengreen's thesis. It ignores the underlying reality of relative interests which underlie any co-operative ventures, more often than not it can be a guise to prop up a stumbling hegemon, as with the Plaza and Louvre accords in the 1980s.[276] The conclusion should rather be that a nation should pursue its own national interest and tailor its economic and monetary policy to domestic macro-economic exigencies.

Drummond (1979) has pointed out that only the US could be said to have deliberately depreciated her currency. In fact I would suggest that clearing agreements and currency areas had a beneficial effect by helping to revive trade. MFN was an impediment to trade, by discouraging regional trade agreements, as a result trade negotiations and concessions were increasingly considered from a bilateral perspective. This was certainly the case with the Gold Bloc. Members were unwilling to increase intra-bloc trade for fear of retaliation. French policy-makers attacked MFN as a fair weather measure, which actually hampered the development of regional trade accords.[277] They argued that regional trade agreements would at least allow a certain degree of liberalisation. It could be argued that the US played-up the role of protection in causing the depression in order to secure a post-Second World War liberal trade regime, which would be in the US's interests. One wonders whether the dominant liberal interpretation of the causes of international economic collapse, viz., that associated with Nurkse and Cordell Hull, which still informs opinion and policy makers, was not sub-consciously concocted to salve the reputation of economic liberalism which had been so shaken by its evident economic and political failure during the inter-war years.

8) Finally, policy is too often judged from an international perspective without taking into account historical experience, and the interaction and contradiction between domestic

[275] see Golden Fetters, p.399.

[276] Co-operation which aims only at stabilising nominal exchange rates, but fails to deal with underlying so-called disequilibria will be ineffective and most likely lead to future distortions, as illustrated by the appalling misjudgments made by Japanese policy-makers, in the mid-1980s, in the face of US demands that the bilateral trade gap be narrowed, whilst leaving the US fiscal gap largely unaddressed.

[277] see chapter six of this thesis.

objectives and international co-ordination, *vide* France's stabilisation. Too often domestic constraints are ignored when passing judgment on policy. To advocate co-operation, as Eichengreen does in the closing lines of his *opus*,[278] implies to subsume these domestic interests to international exigencies, politically this is naive, national politicians rightly answer to their domestic constituencies.

Hopefully this chapter will have helped deconstruct several myths that have surrounded the gold standard and the literature on the inter-war monetary system. The first of these is the notion of the apolitical nature of the gold standard. De Cecco's work and the bimetallist controversy have clearly demonstrated that underlying this was a balance of relative interests, e.g., between creditors and debtors, and that after the First World War the underlying matrix of socio-economic and political factors which had conduced to the stability/acceptability of the *belle époque* gold standard had been fundamentally altered by the appearance of parties self-consciously representative of the working class. The adjustments which the real and monetary shocks required were too costly politically, given relatively fixed cost structures and the sort of disequilibrium adjustment path that we have delineated, for the inter-war gold standard to endure. This chapter should also have put paid to the Nurkse myth, which is still invoked as a mantra by the policy-making establishment and financial journalists, that exchange dumping/competitive currency depreciation are significantly to blame for the Depression as was the averred accompanying trade protection. To attribute a causal role to them is wholly erroneous and constitutes a typical manipulation of historical facts to achieve certain policy ends.

There is no evidence whatsoever that countries other than the US depreciated their currencies deliberately, the force of economic circumstance and the political costs of maintaining deflation *à outrance* became just too acute and politically counter-productive. In France it led to the victory of the Popular Front, in Germany it stoked support for the Nazis, and in the UK it split the Labour party and effectively put it out office. Even in the case of the US Eichengreen has demonstrated that Roosevelt was being impelled by Congressional inflationary lobbies to act. As to trade protection it was not a resultant of currency depreciation more often than not it was employed as an alternative or to palliate the effects of imported deflation resulting from fixed exchange rates. In the case of the UK it

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[278] see Golden Fetters.

did follow sterling depreciation, but Empire Free Trade and Preference had been an abiding and divisive issue in conservative party politics since the turn of the century when Joseph Chamberlain embraced it. It was adopted as policy by the National government in which his son, Neville Chamberlain, was Chancellor of the Exchequer.[279]

[279] Eichengreen (1981) traces the tariff and devaluation debate in the UK and comes to the conclusion that the tariff was adopted because it was felt that devaluation of itself would not be sufficient to redress the trade balance and might lead to further currency depreciation and imported inflation. The tariff was therefore adopted not simply for Imperial reasons, but also for domestic economic purposes and as an alternative to further currency depreciation. Its revenue raising aspect was not ignored either. Eichengreen records that liberals such as Robbins and Benham argued that devaluation would be sufficient as the balance of payments would take care of itself under a floating currency regime.

CHAPTER 3

FRENCH MONETARY POLICY FROM A COMPARATIVE AND INTERNATIONAL PERSPECTIVE TO THE 1933 WORLD ECONOMIC CONFERENCE

WAR FINANCE:

To understand inter-war French monetary history one must begin with the problem of war finance. The French war effort had, to a far greater extent than in Britain, been financed through the issue of short-dated government securities namely, *bons de la Défense Nationale*. There would appear to be two reasons for this. The first being the failure to introduce an operative income tax until 1917.[1] The income tax had largely been the work of Caillaux before the war, but it was not passed until 1914 and only became operative in 1916. The issue of an income tax and capital levy had proved highly divisive before the war and the capital levy had fallen victim to the heated debate.[2] As we have seen in chapter one the issue of a capital levy would continue to be a divisive and unresolved issue in the inter-war years.[3] The second reason was the belief, common it would seem among all belligerents, that the war would be a short one and could be considered a confidence measure as the loser could be expected to pay the costs through reparations payments.[4] The largely floating debt issued to finance hostilities was a major constraining factor in the conduct of economic policy after the war.

Haig (1929) was to contrast unfavourably the French fiscal system with the British, "When war was declared England had immediately available a well seasoned income tax and

[1] The income tax legislation was passed in March 1914, but only became operational in 1916, Kemp (1972).

[2] In fact the debate over the introduction of a more modern fiscal structure had lasted for circa 20 years, Cobban (1978).

[3] Modern reflections on the economics of politics shed a lot of light on problems of this nature in democracies (cf., Buchanan). Quoting Schuker (1976) on the politically intractable problem of fiscal reform, "The differences between the parties were in any case so great that coalitions usually represented a form of negative agreement that could be maintained only by avoiding potentially divisive economic and social issues. The difficulties of pushing through broad financial legislation of any sort in such a situation is obvious."p.62

[4] see Eichengreen <u>Golden Fetters</u>.

supertax administered by an admirable civil service. When the need came, it was necessary only to increase rates."[5]

Ribot who was Finance Minister during the war had opposed income tax and at first did not implement the legislation passed in July 1914. He defended his action on the grounds that he believed hostilities would not last long and that anyway the costs of war were too great and would have to be financed through borrowing. Income tax did become operative in 1916, following the act of 29th December 1915.[6]

A war profits tax was also introduced in July 1916. To complete the income tax, four income tax schedules were introduced on July 31st, 1917.[7] Haig pointed out that in 1915, 1916, and 1917 France had no budget at all.[8]

Truchy (1927) indicated that as the war began while the system of direct taxation was being altered, parliament refused to double existing taxes to avoid further entrenching them.[9] He pointed out that the net effect of the income tax was actually to reduce revenue and that a more effective means of raising revenue would have been to increase the rates on existing taxes.[10]

Haig (1929) pointed out that, "In terms of pre-war francs the 1918 collections were only about half as great as the 1913 collections. During the five years, 1914-1918, the French spent approximately five borrowed francs for every franc from revenue receipts."[11] Truchy's (1927) conclusion was that normal budgetary resources, "only covered a

[5] Haig (1929) p.23. One should note that income tax had been first introduced (temporarily) under Pitt to finance the Napoleonic wars and became a perennial feature of UK fiscal policy under Sir Robert Peel in 1842 (Coffield, 1970).

[6] Haig (1929) p.29.

[7] Haig (1929) p.30.

[8] Haig (1929) p.50.

[9] Truchy (1927) p.215.

[10] Truchy (1927), "The Law of 31st July 1917 abolished the old direct taxes and substituted an income tax by schedules; its net effect was a reduction of revenue of 32 million francs." page 201. He adds, "So far as revenue during the War was concerned, an increase in the rate of the old direct taxes would have been more productive." p.208.

[11] Haig (1929) p.25. Eichengreen (Golden Fetters, p.76) points out that, "Not until June 1917 did total tax revenues, excluding customs, recover to prewar levels." Eichengreen adds that by end 1914 tax revenue in France had fallen 60% and, "To bridge the gap, Parliament raised indirect tax levies, principally customs and excise." (loc.cit., p.75).

comparatively small portion, 16.5 per cent, of the expenditure of the period 1914-1919."[12]

One should note that the fiscal base was reduced during the period of hostilities as ten of France's most prosperous regions (*départements*) were occupied.[13]

Truchy was critical of French fiscal policy indicating that it was only after 16 months of hostilities that France issued its first war loan, in November 1915. The 1915 consolidation issue was for FRF 13bn. of which only FRF 6bn. was paid in cash.[14] There were four large funding loans issued during the war in 1915, 1916, 1917, and 1918. Truchy argued that in fiscal 1919 the authorities should have tried to reduce expenditure, raise taxes and issue a funding loan. However, this would surely have retarded economic recovery and reconstruction. But, perhaps more significantly, would have been politically dangerous as the armed forces were being demobilised. Certainly in the UK a policy of immediate post-war retrenchment was rejected on those grounds.[15]

All commentators (Haig; Truchy; and Sauvy) concur that it would probably never be possible to draw up a balance sheet of the costs of the conflict with exactitude. Quoting Haig, "... when an investigator attempts to learn what the public expenditures of France have been during recent years, he discovers that at present (1929) nobody, not even the French Treasury itself, knows the facts."[16] Sauvy's (1984) view was that France's national accounts for the whole inter-war period would never be known with certainty.[17]

This opinion was shared by G.Jèze (1927) who formed the following judgement, "I shall show presently that the prevailing disorder in the public accounts makes it impossible to draw up an accurate record of the State expenditure."[18] On extra-budgetary accounts he states, "Moreover the transactions on these accounts escaped parliamentary control. Lastly, the heads of services placed in charge of these transactions did not keep systematic accounts.

[12] Truchy (1927) p.211.

[13] see Dulles (1929).

[14] Dulles (1929) p.97.

[15] see Howson (1974).

[16] Haig (1929) pp. XIII and XIV.

[17] Sauvy (1984).

[18] Jèze (1927) p.27.

As a consequence, there was unlimited squandering and some embezzlement; and great obscurity now reigns over the final results of these services."[19] Jèze, who was an acknowledged authority on fiscal matters,[20] was particularly scathing about the slipshod manner in which public finances were recorded.

However, Haig made the point that this lack of fiscal rigour was not necessarily a significant departure from pre-war practices. Even then France failed to cope with its fiscal problems and, "It is clear, then, that the outbreak of the war found France financially unprepared."[21] Dulles (1929) shared this view arguing that before the war France had run deficits and had also developed the practice of maintaining several separate "budgets" and delays in approving the budget were also customary.[22] Truchy (1927) shared this assessment, stating that before the Great War there were delays in voting budgets, that the public debt was high, and that public finances after the war did not mark such a break with the past.

Though the exact figures may never be known, this is of little importance; the order of magnitude can readily be discerned from the following figures (in billions of francs) which give an idea of the significant financial legacy of war:

	Perpetual & Long Term Debt	Floating Debt	Total Internal Debt	External Debt
1914 a	31	2	33	0
1918 a	70	33	103	20
1919 a	98	43	141	29
1919 b	103	79	182	36
1920 b	133	82	215	
1921 b	148	89	237	
1922 b	161	89	250	
1923 b	183	87	270	
1924 b	193	87	280	

Source: Sédillot (1953) pp.234 & 250. a) beginning year; b) end year.

[19] Jèze (1927) p.43.

[20] His Cours de science des finances had run into its 6th ed. by 1922.

[21] Haig (1929) p.23.

[22] see Dulles (1929).

Sauvy gives significantly higher figures for state debt (excluding advances from the Bank of France and foreign debt):

1918	1919	1920	1921	1922	1923	1924	1925	1926	1927
153	218	246	280	293	330	338	345	359	351

Source: Sauvy (1984) vol. III, p.16.

Sauvy (1984, vol. II, p.297) gives the following figures for nominal national income:

1913	1920	1921	1922	1923	1924	1925	1926	1927
41.8	132.0	104.3	118.2	147.5	188.0	209.5	278.0	272.5

Figures in both tables are in bn. nominal French francs.

As can be appreciated from these figures, the debt to GDP ratio more than doubled as a result of the conflict. If one uses Sédillot's figure for total state debt in 1913 and Sauvy's nominal national income estimate we see that the debt/national income ratio stood at 0.79 in 1913. Using Sauvy's data we see that by 1920 the ratio stood at 1.86 and by 1921 had reached a peak of 2.68. The very significant increase between 1920 and 1921 was because of the twin effects of the fall in nominal national income which conformed with the world-wide post-war fall in prices, and increased borrowing to finance reconstruction. The significant effects of price movements on the level of real indebtedness makes clear internal factors which would have to be considered in choosing an exchange rate to stabilise the franc. As we will later argue, British analysts who attacked the rate at which the franc was stabilised failed to take into consideration these domestic constraints.[23] Eichengreen gives the following comparative figures for internal debt ratios, "to national product in 1920 yields 1.64 for France, 1.26 for Britain, and 0.27 for the United States."[24]

The substantial post-war rise in nominal national income would gradually reduce the debt/national income ratio. By 1924 it was down to 1.8. Over the period 1921 to 1924 nominal national income increased 80% whilst total state debt (using Sauvy's figures) by only 21%. In 1930 the debt/national income ratio was near unity at 1.02, over the period 1920-30 total state indebtedness had increased 38% whilst nominal national income by 151.5%.

[23] see Eichengreen.

[24] see <u>Golden Fetters</u>, pp.78-79.

The legacies of war finance meant that post-war French budgets comprised significant rubrics of expenditure which could not be reduced, viz., the servicing of war debt both internal and external, war pensions and reconstruction costs.

One should also note the very significant increase in the proportion of floating to long term debt. From 6.45% in 1914 it rose to a peak of 76.7% at the end of 1919, gradually falling to 45% in 1924. This decrease occurred mainly because of the steady increase in long term debt, whilst the floating element remained fairly constant from 1921. The floating debt significantly hampered monetary management until the *Caisse d'Amortissement* was created in 1926 with the object of consolidating it.

Silverman (1982) gives the following comparative figures: in France 42% of public debt was short and medium term and in the UK 23% of debt was short term. Service of the British public debt absorbed 30% of the early post war budget and in France nearly 50% of the "ordinary" budget of 1922.[25] Eichengreen provides the following figures, "In 1920 public debt service amounted to 31 and 23 percent of central government expenditure in the two countries,"[26] however, defense outlays in France accounted for 51% of expenditure against 25.5% in the UK.[27] It was the combination of both rubrics of budgetary expenditure in France which made the fiscal problem intractable, and the short term maturity of the debt which translated in repeated and acute treasury and financial crises.

Having attempted to sketch an impressionistic portrait of the fiscal situation inherited from the war and post-war reconstruction[28] it is perhaps useful to examine the monetary situation, and in particular the very substantial increase in the note circulation.

It is significant that the increase in advances to the state accounted for practically the whole increase in note circulation during the war. A substantial proportion of war expenditure not covered by fiscal revenues was paid for by the simple expedient of printing money.

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[25] Silverman (1982) p.15.

[26] see Golden Fetters, p.118.

[27] see Golden Fetters, p.113, table 4:1.

[28] see also chapter four of this thesis.

		Total Advances to the State	Total Note Circulation
23-7-1914		n.a.	5,912
end	1914	3,900	10,162
	1915	5,630	13,201
	1916	9,200	16,678
	1917	15,720	22,337
	1918	20,676	30,250
	1919	29,255	37,275

Source: Sédillot (1953) p.237. Figures in millions of francs.

Sédillot also gives a table which records the steady increase in the ceiling applied on notes in circulation:[29]

		Ceiling in bn. Francs
Law	29/11/1911	6.8
	05/08/1914	12.0
Decree	11/05/1915	15.0
	15/03/1916	18.0
	15/02/1917	21.0
	10/09/1917	24.0
	07/02 1918	27.0
	03/05/1918	30.0
	05/09/1918	33.0
	25/02/1919	36.0
Law –	17/07/1919	40.0

The large floating debt hampered the conduct of monetary policy in both France and the UK as interest rate policy had to be conducted in such a way as to ensure its periodic renewal. The substantial floating debt created a potential inflationary overhang over the French economy. Furthermore, the *bons de la Défense nationale* were rediscountable at the Bank of France till 1926.

Another consequence of the war in France was that the *double plafond* had been substantially raised during the conflict leading to a fivefold increase in the note circulation over the period. At the outset of hostilities the Bank of France immediately opened a credit

[29] see Sédillot (1953) p.236.

facility of 2.9bn. francs for the Treasury under the previously agreed Convention of 11/11/1911. The Bank itself was well prepared for the outbreak of war with the dispositions regulating the behaviour of Bank branch managers carefully laid-out in the *circulaire bleue*, to be opened in case of general mobilisation.[30]

The note circulation and advances from the Bank of France were regulated by the system known as the *double plafond*, which set ceilings on both issues,[31] - there were no mandatory reserve ratios. These ceilings were determined by majority vote in parliament,[32] during the hostilities the government was empowered to raise the limit on the note circulation by simple decree. The ceilings were usually set rather higher than needed at the time of introduction to allow greater leeway. This, in the post-war period, would help feed inflationary expectations.[33] Not surprisingly this ceiling was constantly raised,- a useful, if insidious, form of taxation (forced savings and *seigniorage*) with less political risk attached to it than a rise in taxes which specifically and overtly affects various groups within society. The ability to raise revenue through the inflation tax may well have reduced the pressure on the authorities to pay for the war from increased taxation. At the beginning of this chapter we noted the impact on the debt/national income ratio of the substantial rise in nominal values, a proxy for the level of forced savings. A measure of the rate of *seigniorage* would be the average level of cash balances adjusted for the rate of inflation.

During the war the French franc held up rather well on the exchanges, due to support operations by means of US loans channelled through London. However, all loans and support facilities were suspended after the cessation of hostilities and soon the French franc was trading at a wide discount to its pre-war gold parity.[34]

The third major factor that is necessary to understand the conduct of early post-war French monetary history is the intractable problem of reparations and war debts which largely contributed to the unbalanced budgets of the early 1920s.

[30] see Ramon (1929).

[31] The ceiling to the note issue was set at 41 *milliards* on 31st July 1919. See Perrot (1955).

[32] Wolfe (1951) p.15.

[33] Quoting Jeanneney (1976), "*On a quelque peine à mesurer la force du fétichisme attaché, dans les années vingt, à deux données financières: le cours de la livre et le plafond de la circulation.*" p.200.

[34] see Appendix for nominal, and "real" exchange rates.

It has been alleged that the campaign in favour of Germany meeting French reconstruction costs, which had contributed to the illusion that France's budgetary situation was sound, was foisted on Klotz who had to adopt the slogan, "*le boche paiera.*" The campaign was mounted in order to deflect government from considering a capital levy to which it was thought that Klotz might be favourable. His successor, François-Marsal, did not favour a capital levy. Haig has argued that Klotz was quiescent on the tax front in 1919, awaiting the results of the Versailles peace conference.[35]

It was in 1920 that the budget was divided into three headings, viz., i) ordinary budget; ii) extraordinary budget (to finance military expenditure); iii) and the budget of recoverable expenditure whose liabilities, *bons de la défense nationale* (issued by the *Crédit National* which had been created in 1919 for the purpose of funding reconstruction expenditure) were backed by its assets, viz., France's claims to German reparations liabilities. The French government assumed liability for domestic reconstruction costs. As it was assumed that Germany would pay it has been argued that there was too little control over disbursements and claims.

Haig (1929) notes there was a precedent for an extraordinary budget as one had been adopted after the war of 1870.[36] Dulles (1929) points out that many claims for war damage were paid out in 1919-22, and that a very large number were made in bonds, e.g., *bons de la défense nationale*, *rentes*, and, *obligations*.

Haig points out that in 1920 the socialists had proposed a capital levy to resolve the fiscal crisis of the state, but this was rejected by the Finance commission of the Chamber.[37] The issue of a capital levy was a perennial feature of the political and fiscal debate during the 1920s. At the time it was believed that the tax reforms of 1920 would represent the last effort needed.[38] The most signal reform was the introduction of the business turnover tax (*taxe sur le chiffre d'affaires*), which the left opposed and were later to blame for the high cost of living.

Alongside fiscal measures such as the business turnover tax, the so-called François-

[35] Haig (1929) p.56.

[36] Haig (1929) footnote 23, p.77.

[37] Haig (1929) p.65.

[38] Haig (1929) pp.69-70. One should also note that 1919 was an election year.

Marsal convention (after the then Finance Minister) was passed on 29/12/20 with the Bank of France. This aimed at an annual reduction in the note circulation of 2bn. francs. These measures were part of the post-war effort at restoring public finances.

Dulles was critical of the François-Marsal convention and argued that it made the government treasury problem more acute. She argued that reimbursements under the convention virtually equalled the maximum extent of the "*faux bilan*" (see below) and that the Treasury had to borrow from private banks and resort to other subterfuges to try and honour the convention.[39] This was Pierre de Moüy's forecast. He was head of the *Mouvement Général des Fonds* (Treasury) under the *Cartel*. Dulles argued that in 1925 the, "strain on public resources led to an increase of certain parts of the debt, notably the advances of the Bank to the state, which was almost precisely equivalent to the reductions of the bons du trésor and parts of the debt,"[40] i.e., any decrease in debt outstanding as a result of the François-Marsal convention was offset by a near one to one increase in the note circulation.

Dulles reckoned that the François-Marsal convention, which was meant to be a deflationary strategy, blinded the public and led to the "*faux bilan.*" "In fact, many of the troubles of France can be traced back to the François-Marsal convention of 1920 which led to concealed inflation."[41] Dulles noted that a policy similar to the François-Marsal convention had been followed after the war of 1870.[42]

Dulles' argument was that the François-Marsal convention merely exacerbated the significant treasury difficulties which would plague governments until the Poincaré stabilisation, "...the trouble with the budget arose, in the first place with the growing debt charge and, in the second place from large unpredictable drains on the treasury for repayments of maturing national defense bonds, both of which facts led to increases in the advances by the Bank of France to the state."[43]

Dulles argued that these difficulties were compounded by shifts in confidence,

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[39] Dulles (1929) p.237.

[40] Dulles (1929) pp.381-382.

[41] Dulles (1929) p.241.

[42] Dulles (1929) p.231.

[43] Dulles (1929) p.394.

particularly under the first *Cartel* government. "The more general factors which lay behind the inability of the state to float new loans or pay the interest on old loans was, in the last analysis, confidence, which varied sharply from day to day."[44] Dulles argued that shifts in confidence were particularly apparent on the foreign exchanges in the period up to 1926.

"The consideration of the more important fluctuations of the franc value during these years makes it plain that at no time was an economic factor, or even a group of economic factors, as immediately important to the franc as was the tide of public confidence."[45]

Dulles' opinion was widely shared by contemporaries such as Pirou (1936). Lately the question of "confidence" has been the subject of some debate. The argument centres around the rationality of shifts in "confidence", viz., were sudden movements in exchange rates destabilising,[46] stabilising,[47] or based on a rational shift in expectations[48] as in 1926? Without wishing to enter into this debate, what is of importance during this period particularly from the Ruhr occupation in late 1922 until 1926 when the French franc was subject to severe fluctuations, was the public perception that exchange depreciation and inflation went hand-in-hand.[49] This was reinforced by the sharp movements in the exchanges which suggested that it was exchange movements which were a cause of internal inflation.[50]

Quoting Dulles, "From June 10, 1922 to the end of 1926 the exchange movement dominated wholesale and retail prices."[51] This need not signify "destabilising" speculation, rather the "efficiency" (*pace* Tobin) of foreign exchange markets as opposed to the more sticky domestic price level which tends to be more inertial. The French post-war experience

[44] Dulles (1929) p.395.

[45] Dulles (1929) p.335.

[46] see Sicsic (1992).

[47] see Eichengreen (1992).

[48] see Sargent (1983).

[49] see Eichengreen Golden Fetters.

[50] Rogers (1929); & Wolfe (1951).

[51] Dulles (1929) p.157.

with inflation and currency depreciation would colour the subsequent devaluation debate.[52]

If one is to develop a holistic view of the course of French inter-war economic and monetary policy one must also study the question of reparations which impacted on post-war French budgets by creating the illusion that Germany would pay.[53] The Ruhr invasion, in order to prosecute the claim to reparations, also contributed to the exchange crisis of 1924.

REPARATIONS, WAR DEBTS AND POST-WAR FINANCE:

We shall attempt to deal with the problem of reparations from a more political perspective than is usually the case in the economic literature.[54] This is because we feel that the nature of the problem has been misconceived and sidetracked by the famous controversy sparked off by Keynes and the later Keynes/Ohlin debates in the Economic Journal. At heart it was as much, or more, a political than a purely economic problem.

Quoting Montagu Norman, "This question of reparations is not as it should, and as Mr. Keynes assumes it to be, a purely economic question. It is almost entirely a political question over which the French government is forced to tug in one direction and the German government in another."[55]

A look at the outcome of the Versailles Treaty negotiations will help develop a better understanding of the complexity of the reparations problem and French security preoccupations, and the intangible link between the two. But, first one must underline the fact that it was an intrinsic part of French demands that Germany should pay for the war. This was determined by the political mood of the people and the parliamentary system. For no government would have lasted that would have suggested that the French taxpayer should pay, and the apportionment of the costs amongst various social groups would have proved

[52] see Eichengreen Golden Fetters.

[53] see chapter four of this thesis.

[54] The precedent has been set by the Prussians after the French defeat of 1871. The French paid within 3 years which affected the French perception of the problem.

[55] From Davis (1975) p.262 (footnote). The source is a letter dated 3/5/1921 from Governor Norman to Governor Strong of the F.R.B.N.Y.

F.Machlup (1970) reckoned that from a purely economic perspective Germany could have paid. However, the problem was political and many Germans were opposed to reparations on principle, see Schacht's memoirs (1955).

intractable. Klotz, Clémenceau's Finance Minister, made it his declared policy that, "*le boche paiera.*" Incidentally, the Germans had planned to exact reparations from the French should they win the war.

There is a tangible political and diplomatic link between reparations and French security preoccupations. Trachtenberg (1979) has provided a more favourable perspective on France's negotiating stance, arguing that the UK was at first the most intransigent ally. However, Lloyd George was facing an election and presiding over a coalition government. Also it may be argued that the UK's stance was coloured by the fact that France at first appears only to have considered civilian destruction caused by the hostilities as Germany's liability, excluding war expenditure. If that were the case clearly Belgium and France would get the lion's share, hence, the UK's demand for a more general indemnity. Though Trachtenberg makes this distinction he fails to analyze whether this conditioned the UK's attitude, viz., in order that it might qualify for an appropriate indemnity.

Néré (1975) has pointed out that Poincaré, who initiated the Ruhr occupation, was President at the time of the Treaty and thereafter chose to preside over the Reparations Commission, "did he look upon reparations payments as a means of neutralizing Germany should the need arise?"[56]

The French at Versailles, and in particular Foch had wanted material guarantees of French security, such as the permanent occupation of the left bank of the Rhine or the maintenance of permanent garrisons along this "natural" border. French strategists from Louis XIV to Napoleon (who actually managed to extend France's borders to the Rhine) had considered this to be France's "natural" border. However, this policy was rejected and the French had to settle for a 15 year occupation of the Rhineland with a phased quinquennial timetable of withdrawals dependent on Germany's fulfilment of its reparations obligations; the use of the Saar coalfields to compensate the French for the mines which had been deliberately destroyed by retreating German forces;[57] the return of Alsace-Lorraine to France; and an Anglo-American guarantee to meet France's security preoccupations. The fate of the Saarland was to be determined by a plebiscite after 15 years following the

[56] In this context one should bear in mind the French objections with regard to the Dawes plan of transferring responsibility for declaring Germany in default from the Reparations Commission, under French control, to the Agent General for Reparations.

[57] Rather as retreating Iraqi forces destroyed Kuwaiti oil fields.

precepts of Wilson's fourteen points. Wilson had threatened to leave Paris unless France agreed to give up its claim to annex this territory.

The provision for an Anglo-American Treaty of guarantee was never forthcoming owing to the US's increasingly isolationist foreign policy. The US Senate also failed to ratify the Treaty of Versailles and thus enter the League of Nations. The British refused to give the French any formal guarantees. This exacerbated the feeling of French insecurity and arguably conditioned its attitude towards Germany and its reparation obligations.

No definitive figure was set for the reparations obligations until 1921, when they were set at 132 billion gold marks and were represented by 3 types of bonds, A, B, and C.[58] The reparations were justified by the war guilt clause[59] rather than on a purely economic basis, viz., the destruction of part of France's ten most prosperous *départements*, a policy which, Brogan (1945) argues, merely antagonised the Germans.

The reconstruction of these *départements* was to be financed not through fiscal revenues, but by borrowing on the anticipated proceeds of reparations payments. The *Crédit National* was created in order to finance the reconstruction expenditure by issuing *bons de la défense nationale*. The French budget was therefore divided into the *budget ordinaire*, - to be balanced,- and a *budget des dépenses recouvrables* to be financed by borrowing. These were merged in fiscal 1921, but reappeared the next year. A third budgetary category existed which was also financed by borrowing, the *budget extraordinaire*. The latter had been established to finance war expenditure and this category was only merged into the *budget ordinaire* in 1922,- it reappeared in 1936 under the pressure of rearmament. The *budget recouvrable* were only merged into the *budget ordinaire* in January 1926.

The existence of three distinct budgetary categories illustrates the extent to which France's immediate post-war finances were built on illusions, viz., on the assumption of significant reparations payments. This was an essential contributory factor to the ongoing monetary and fiscal crisis. Only the *budget ordinaire* was to be balanced. Furthermore, the *budget des dépenses recouvrables* and the *budget extraordinaires* were not solely financed by borrowing, which would have been the financially "sound" approach, but by printing

[58] It would seem that even at the time it was recognised that the likelihood of Germany's honouring type C bonds which implied a Schedule of payments possibly stretching over the next two generations as, perhaps, fairly remote. This is an impression gathered from a general reading of the literature.

[59] Clause 231, cf., Néré (1975) p.20.

money and by significant issues of short-term *bons de la Défense nationale* which acted as a constant potential inflationary overhang, i.e., quasi-money. This demonstrates that France's finances were not only built on an illusion, but also on unsound financing of budgetary expenditure.[60] Nevertheless, until there was some prospect of budgetary action or currency stabilisation, both of which were intrinsically linked, there was little prospect of debt funding.

However, the so-called recoverable budget answered to a political imperative. Quoting Silverman (1982), "As to the recoverable budget, Klotz viewed it as, "not only a budgetary necessity, but also a political necessity." To have inscribed such expenses, for which others were liable, in the ordinary budget would have presented a false picture of French finances."[61]

BRITISH POST-WAR STABILISATION POLICY:

The UK provides a useful comparative experience because it is in many ways the mirror image of France's. An over-valued fixed exchange rate during the 1920s required a perverse deflationary macro-economic policy and caused imported deflation, whilst France, with an undervalued exchange rate,[62] enjoyed economic prosperity. By contrast, in the 1930s France had an overvalued exchange rate and the accompanying deflationary policy meant that her economic performance was far weaker then than that of the UK.[63] The most articulate recent exponent of this view is Eichengreen (Golden Fetters).

In the decade 1919-29 France recorded a rise in real GDP of 78.5%; the UK 10.9%;

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[60] see chapter four of this thesis.

[61] Silverman (1982) p.99.

[62] see Sicsic (1992); and figures for the relative competitive position in the Appendix.

[63] Redmond (1988) has produced estimates of effective exchange rates (i.e., using weights derived from the balance of trade), rather than bilateral rates as we have calculated (see Appendix). He argues that his figures demonstrate that bilateral rates over estimate the degree of exchange rate misalignment in the 1930s. However, trade flows are not uncorrelated to relative prices, as a result his figures would show a downward bias. Additionally, if one accepts our argument that one of the more significant causes of depression (aside from perverse policies) was imported deflation, then surely one should not ignore the impact of bilateral exchange rates, both nominal and real, against key currencies (see chapter four where we explore this further). One should note too that despite his claim to the contrary his figures do indicate significant shifts in effective exchange rates (*q.v.*, *loc.cit.*, p.402, table 4).

whilst during the decade 1929-39 France registered GDP growth of only 3.4%; and the UK 19.6%.[64] The particularly impressive performance registered by France in the first post-war decade is part due to its significantly lower level of activity in 1919 compared with 1913 than in the UK. A major factor in this fall was the occupation, and the proximity of hostilities to France's industrial base.

Both countries suffered post-war recessions in 1921 which were due to both an unravelling of the war-time credit boom which had been sustained in the first post-war year, and the considerable drop in world commodity prices. The UK remained stuck in recession, whilst France prospered with a slight dip in the immediate post-Poincaré stabilisation period during 1926-27. From 1929 to 1931 France appeared blissfully immune from depression and attracted very large gold inflows (or as some argued helped precipitate them).

It is Eichengreen's opinion that this "gold avalanche" allowed France to maintain a looser credit policy and helps explain the late onset of depression in France.[65] Mouré adds that the "gold avalanche" reaffirmed the Bank's belief in the correctness of its policies.[66] However, following the devaluation of sterling in September 1931 and the dollar depreciation from April 1933 to January 1934, France, with a now over-valued exchange rate, imported deflation.[67] That is the high real rate of exchange meant that the domestic traded goods sector faced downward pressure on prices from abroad. This is the converse effect to imported inflation which characterised the Bretton Woods monetary standard. The lesser costs of inflation compared to the arresting impact of deflation help explain the longevity of the Bretton Woods dollar standard. Deflation, both imported and policy induced, exacerbated budget deficits. The strictures of financial orthodoxy[68] mandated reductions in public expenditure which added a perverse twist to deflation. As a result the economy gradually fell into recession and depression.

One should also note the very high levels of real interest rates in France during the period 1931-35. A measure of the monetary/credit squeeze is recorded in Lutfalla & Patat's

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[64] Figures compiled from A.Maddison (1991).

[65] see Golden Fetters.

[66] Mouré (1991) p.78.

[67] see also Eichengreen Golden Fetters.

[68] see chapter five of this thesis.

figures (1986) for M2 (see Appendix) which record a significant drop in the rate of growth over the period 1931-36. Interest rates had been negative in the immediate post-war years excepting 1921-22 and again from 1936 as prices rose under the impact of deficit financed re-armament.[69] In 1937 M2 grew by 11.3% and in 1938 by 10%. From the beginning of 1931 to end 1935 M2 had dropped a cumulative 14.28%.[70]

Not till the successive devaluations of 1936-37-38 and the impulse of re-armament did the French economy begin to pick-up. The UK though, with the benefit of a managed exchange rate, had enjoyed, since 1932, a return to prosperity and concomitant balanced budgets. The floating exchange rate had allowed the British authorities, under the able stewardship of Neville Chamberlain at the Exchequer, to abandon the perverse deflationary macro-economic policies which had been imposed by the fixed exchange rate commitment.

Britain's return to gold at its pre-war parity was part conditioned by war finance which had been less inflationary than French. The war had been financed by the issue of currency notes by the Treasury with no fixed limit;[71] by "ways and means advances" from the Bank to the Treasury; by borrowing via the issue of Treasury bills,- short-dated floating government debt,- and increased taxation. As in France the large floating debt was to constitute a constraint on the conduct of monetary policy, until 1922,[72] as the government was obliged to make bills an attractive asset to hold until the debt could be funded. Furthermore, the Bank of England had really lost control over monetary policy and it was the fixed rate on Treasury bills sold on tap that determined the conditions on the money market.

If one compares the increase in the cost of living over the period 1914-1919 we find that French prices rose 168%, whilst British prices rose 119%. Contrasting the cumulative behaviour of the cost of living index during the decade 1919-1929 shows clearly the deflationary impact of British policy during that decade. The cumulative decline in the British cost of living index was: 23.7% whilst French prices rose 132%.[73]

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[69] see figures for year-on-year consumer price inflation and nominal interest rates in Appendix.

[70] Lutfalla & Patat (1986).

[71] With no mandatory reserve backing apart from government paper.

[72] see Moggridge (1972); and Howson (1975).

[73] Figures from A.Maddison (1991).

The Cunliffe Committee[74] recommended a gradual consolidation of currency and bank note issues,[75] balancing the budget and a return to gold as a means of curtailing inflationary finance and as a means of restoring pre-eminence and prosperity to Britain and the City. It was believed that a return to gold would restore world trade and foreign lending, both of which seemed to go hand-in-hand. Hence, it has been argued the pre-occupation of the British with the economic stabilization of Germany and Central Europe,[76] as opposed to France's more nationalistic approach determined, arguably, by foreign policy pre-occupations.[77] It is important to note the divergent national interests of the French and British. Policy in the former being far more dependent on political and security considerations and in the latter on restoring the pre-eminent role of the City and a liberal international economic order.

The British economy underwent a boom/bust cycle as financial controls were dismantled after the war. This was accompanied by a falling exchange rate against the dollar as the system of support set up during the war for sterling, and for the franc, was dismantled in March 1919. Sterling fell less against the dollar than did the franc.

The British did not introduce "dear money" immediately after the war. Howson (1974) has argued that this was to avoid social unrest as the troops were being demobilized. However, on 15th April 1920 dear money was imposed to stem the inflationary tide. There was a fear that sterling would go the way of the mark. Keynes supported this policy,[78] as did Hawtrey. Bank rate was kept at 7% for a full year. Some have argued that this is what caused the precipitous price deflation, but Howson has argued that the previous tightening of monetary policy (following the Cunliffe Committee's recommendations and the effects of

[74] Cunliffe Interim Report, pub. 1918.

[75] The currency and bank note issues were finally merged under the "Currency and Bank Notes Act, 1928." The Chamberlain/Bradbury Committee, 1924, also dealt with this problem as well as that of the return to gold.

[76] In particular Montagu Norman and also Benjamin Strong, see the biographies by Boyle (1967); and Chandler (1958).

[77] To the French and in particular Moreau, the British under the seemingly benign guise of *laissez-faire* and the gold standard,- both of which are synonymous,- were attempting to impose, the "imperialism of free trade."

[78] see Keynes' letter to A.Chamberlain in, Howson (1974) p.102.

the "Bradbury trick" and the "Cunliffe limit", both of which exercised deflationary pressure)[79] and funding attempts had already set off deflationary forces. However, one should not ignore the effects of bank rate at 7% for a full year, this was very high by historical standards.[80] And the very high level of real interest rates that this yielded,- consumer prices fell 9.7% in 1921 and 19.2% in 1922! The effects of the deflationary external shocks coming from the US would have further exacerbated this process, though it is Eichengreen's thesis that the rest of the world was largely insulated behind floating exchange rates from this deflationary shock.[81] As can be appreciated these deflationary efforts find something of a counter-part in the policies initiated by François-Marsal in France. The significant difference being, the still high level of reconstruction expenditure in France, and the Ruhr invasion by French and Belgian troops at the beginning of 1923 which would add to uncertainty, as would the later fiscal deadlock over the *double décime*.

Britain's monetary and fiscal policy became deflationary after the formal adoption, in Dec. 1919, of the Cunliffe Committee recommendations, in an attempt to return to pre-war par,- the inexorable rise in unemployment had begun. As an essential ingredient of this policy was the appointment in 1921 of the Geddes Committee on National Expenditure which resulted in reductions in public expenditure, pejoratively known as the "Geddes Axe."[82] Part of this policy of returning to gold parity was the settlement of the Anglo-American war debts on 31st Jan. 1923,- essential for obtaining a stabilisation loan.

THE FRENCH EXPERIENCE:

France's early post-war policies displayed certain similarities to those of the UK as was

[79] The "Bradbury trick" consisted in backing the issue of currency notes (issued by the Treasury during the war) fully with Bank of England notes so neutralising their effect on the money supply. The "Cunliffe limit" fixed as the max. note issue for a particular year the max. attained in the previous year. See Sayers (1976) Appendixes, pp.62-63.

[80] see Hawtrey (1938).

[81] see Golden Fetters.

[82] The Geddes Committee Report was officially known as, "First Interim Report of the Committee on National Expenditure", P.P., 1922, Cmnd. 1581, which was, "to make recommendations to the Chancellor of the Exchequer for effecting forthwith all possible reductions in the National Expenditure on Supply Services, having regard especially to the present and prospective position of the revenue." See Hancock (1962).

stressed by Silverman (1982). He argued that Schuker (1976) was misguided when he characterized French economists as inept, as French monetary policy resembled British. But, given different political structures; legacies of war finance; foreign policy considerations; public expectations opinion as to who should pay for the war; and, differing views on how national finances should be constructed, different end results ensued. This is a view with which I concur.

Under the François-Marsal Convention [83] of April 1920,- which may be compared with the similarly deflationary policy undertaken in Britain, viz., the "Bradbury trick" and the "Cunliffe limit," - the French government resolved to progressively reduce by 2 *milliards* a year the advances from the Bank to the government, which then stood at 27 *milliards*.

The obligation under the François-Marsal Convention to reduce outstanding advances by the Bank of France by FRF 2bn. per annum was fulfilled during the first year, but then decreasingly so.[84] It was not until Poincaré returned France to the gold standard, on 25th June 1928, that the advances were fully repaid out of the proceeds of the Bank's revalued gold stock (purely a book-keeping exercise). However, economic recovery progressed as a result of inflationary reconstruction expenditures, which stood at FRF 8bn., and the concomitant budget deficits - though the process was temporarily broken by the downturn of 1921. Had France not adopted such a policy there would have been a severe economic and political crisis.

In 1922 Germany defaulted on reparations deliveries in kind and in January 1923 Poincaré, now Prime Minister (*Président du Conseil*), ordered the occupation of the Ruhr. This operation was conducted in conjunction with the Belgians. It had been hoped that this would solve France's budgetary problems by ensuring Germany's fulfilment of its reparations obligations,- and quite, possibly, to ensure the subjugation of Germany.

The Germans responded with a policy of passive resistance, which lasted until Sept. 1923. Payments to those resisting were made by printing money which greatly exacerbated the inflationary process already under way in Germany. Although the policy of passive

[83] François-Marsal was then Finance Minister, Poincaré Prime Minister, and Pallain Governor of the Bank of France (he held the office from 1897-1920).

[84] In 1922: 1 *milliard* was paid; 1923: 800 millions; 1924: 1.2 *milliards* and by 1st Jan. 1925 the avances had been reduced to 22 *milliards*. However, under Herriot they were raised, and eventually reached 39.5 *milliards* on 4th Nov. 1925!

resistance can be said to have partly failed it became quite clear that the "*dépenses recouvrables*" were far from being so,[85] in spite of the cooperation of the Ruhr industrialists with the M.I.C.U.M..[86] During this period there had been talk in France of fostering separatism in the Rhineland, around which a protective tariff barrier had been erected, and of setting up an independent bank of issue.

Speculation built up against the franc during this period as it became obvious that the French budget had become in part fictitious. Eichengreen argues that the crisis was precipitated when it became apparent that there would be a substantial budget deficit and after the government had to request the passage of an "exceptional" law to allow it to disregard the provisions of the François-Marsal convention.[87] This substantiates Dulles' opinion that the convention was destabilising as it set a target which could not be met. It has been argued that speculation against the franc was conducted by German banks in Amsterdam to force the French to withdraw. Poincaré, amongst others, argued the case.[88] However, it is generally thought that though the Germans and British were not displeased with the outcome,[89] the speculation was, to a great extent, due to the spontaneous activity of private individuals.

Poincaré brought the speculation to a halt by contracting a six month revolving credit from Morgan's of $100 million [90] and a £4 millions sterling credit from Lazard's in London. He used the proceeds to operate on the forward market (driving the franc up) and

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[85] Quoting Perrot (1955) p.137, "*Alors qu'à la fin de l'année 1923, M. de Lasteyrie, Ministre des Finances faisait espérer un excédent budgétaire, la cessation des paiements allemands de réparations oblige, au moment même où se déclenche la crise des changes du 14 Janvier 1924, à fondre dans le budget général ce que l'on appelait jusqu'alors les dépenses << recouvrables >>.*"

[86] The acronym MICUM stood in English for "Interallied Mission of Control of Factories and Mines".

[87] see Golden Fetters, p.177.

[88] It has been argued by some that this encouraged the Germans to stabilize their currency.

[89] Perrot (1955) quotes Poincaré as stating in the Senate in March 1924, p.161, "*Cette crise n'est qu'une offensive politique contre notre nation. L'attaque est d'origine allemande: miner le franc pour nous forcer à évacuer la Ruhr.*" But she adds, p.162, "*Il est plus facile d'expliquer une crise par le besoin de vengeance des Allemands que par ses propres fautes de gestion financière.*"

Schuker (1976) opines that, "In summary then, neither the German nor the English government seems to have taken part directly in a manoeuvre against the French currency. On the other hand, both Berlin and London welcomed the franc's fall and confidently expected this development to force the French to be more amenable to an "international" solution to the reparations problem." p.102.

[90] The government had agreed that if they could not find the necessary foreign exchange to repay the credits they would honour it with the gold of the Bank of France (I do not believe that the Bank of France acquiesced in the matter).

so squeezing the "bears" who had speculated on a fall in its value.[91] The forward discount on the franc was reversed as speculators were forced to cover short positions. This operation arrested the downward speculative pressure on the franc which no doubt had an internal inflationary bias, in turn encouraging further speculation.[92]

The rapid appreciation of the franc in 1924 and again in 1926 under Poincaré is the source of the debate over whether speculation was destabilising or not. Contemporary analysis laid great store on the question of "confidence." According to Dulles (1929), "The conclusion resulting from the study just outlined is that confidence was the principal short-run determinant value of the franc. This emphasis on psychological factors should not lead either to skepticism or to inertia in the attempt to control financial forces."[93] The emphasis on psychological factors was widely shared. It is easy to see how the thesis came into being as on the two occasions when a serious attempt was made to deal with the financial crisis, both in March 1924 and July 1926 the franc appreciated very rapidly.[94] However, what is more interesting is to explore what underlay the essentially "rational" run on the franc.[95] These were very real factors, i.e., political instability, treasury problems, budget deficits and foreign policy adventures.

Poincaré accompanied his "bear squeeze" with the introduction of a "*double décime*",- an across the board increase in taxes of 20%,- along with cost saving administrative reforms.

It appears that fiscal reform (balancing the budget) had been a precondition for the Morgan loan,[96] though acceptance of the Dawes commission had not been. Eichengreen notes that de Lasteyrie, the Finance Minister, had originally opposed new taxes or loans as

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[91] The whole operation proved profitable and Herriot tried to convince Robineau, the Governor of the Bank of France, and a friend of Poincaré's, to try and replicate the experiment in 1925, but Robineau refused on the grounds that it needed to be accompanied by fiscal measures (also, I believe, that on this occasion speculators were not short). This, it has been averred, is one of the reasons Caillaux dismissed Robineau when he became Finance Minister in 1926. Caillaux appointed Moreau as Governor and Poincaré clearly always thought of Moreau as Caillaux's man.

[92] see Pirou's (1936) so-called psychological theory.

[93] Dulles (1929) p.52.

[94] see Rogers (1929).

[95] see Sargent (1983); and Eichengreen (1982) & (1992).

[96] see Eichengreen Golden Fetters, p.177.

reparations payments had been expected.[97] In the event he proposed the "*double décime*" which constituted an attempted political compromise. Poincaré's programme was passed in the Chamber of Deputies, being opposed by the radicals, but was rejected in the Senate and his government fell.[98] The franc had begun to weaken again with the prospect of an electoral victory for the *Cartel des Gauches*. The elections which followed in 1924 replaced the "*Chambre bleu horizon*" by a Chamber more to the left and marked the advent to power of a *Cartel des Gauches* government under the Radical leader E.Herriot. The socialists did not participate in the *Cartel* government, but supported it.

The fact that the socialists supported a capital levy did not inspire confidence. Haig (1929) has recorded that, "The Left, on the other hand, protested against the inclusiveness of the double décime and proposed increased taxation of the rich as the correct solution."[99] The right opposed this in part arguing that this would be a capitulation to Germany. Again in 1925 Painlevé would try and introduce a capital levy and a moratorium on bonds, but fell when the moderate radicals voted against him.[100] Haig suggests that the socialists were only willing to support the very short-lived July 1926 Herriot government to the extent that it would be willing to introduce a capital levy.[101]

Herriot's major preoccupation was the settlement of the Ruhr question.[102] This was

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[97] see Golden Fetters, p.176.

[98] On the intractable question of fiscal reform/policy, which had in a sense been papered over by the idea that Germany would pay, Shuker (1976) would comment, "when reparations payments did not materialize to any appreciable extent the French proved unable to reach a national consensus on taxation sufficient to meet their budgetary needs. They had recourse instead to an increase in the floating debt - that is, short-term obligations requiring frequent renewal - of such magnitude as to erode the value of the franc and endanger the whole structure of public finance." p.12. Quoting Perrot (1955) as regards the political nature of the inflationary problem and hence of the exchange crisis, p.138, "*Le débat sur le double décime dura, malgré la gravité de la crise de spéculation contre le franc du 18 Janvier au 22 Mai.*" And referring to the later exchange crisis, Perrot p.154, "*<<L'idée qui domine au Palais Bourbon est la crainte de voter de nouveaux impôts. Le spectre du double décime hante les esprit de tous les groupes de la chambre>> écrit l'Economiste Français, le 30 janvier 1926.*" Referring to the whole period 1924-1926, p.188, "*Le refus ou la lenteur inexcusable du Parlement à prendre les mesures indispensables, montrent combien la crise monétaire a été en fait une crise du régime politique.*" And again, p.188, "*la crise financière est donc essentiellement une crise politique.*"

[99] Haig (1929) p.95.

[100] Haig (1929) pp.124-26.

[101] Haig (1929) pp.159-160.

[102] The initiative to set up the Dawes Committee of experts came from the US, in 1922/3, and was approved by Poincaré.

a reversal of Poincaré's aggressive foreign policy which had been largely disowned by the electorate. Herriot was his own Minister for Foreign Affairs. French occupation was proving expensive and did not result in any net revenues to the French government when account is taken of occupation costs.[103] Herriot's first move on being appointed Prime Minister was therefore to go to London,- totally unprepared[104],- to discuss the matter with the British Prime Minister Ramsay MacDonald, a fellow "socialist" whom he felt he could trust. The French did not get the definitive security guarantees which they had sought, and one gets the impression from reading Schuker (1976) that Herriot was completely duped by Ramsay MacDonald and the Foreign Office. French withdrawal from the Ruhr was agreed upon subsequently on condition of an appropriate debt settlement, which the French failed to secure. The French had wanted the commercialisation of reparations on the grounds that it would make them less susceptible to renegotiation or default. Germany was particularly opposed to this policy as were the British who sought, in particular Montagu Norman, a revival of Germany to stimulate Britain's foreign trade.[105] Commercialisation of the debt only came with the Young Plan.[106]

Withdrawal from the Ruhr was eventually put into effect under the Dawes Plan, which was accompanied by a loan to help stabilize the mark.[107] Under the Dawes Plan a Transfer Committee was established under the American, Parker Gilbert. Its function was to hold reparations, which were made in marks, in escrow if the transfer across the exchanges was likely to upset the mark exchange. This feature had been opposed by the French who had

[103] Quoting Silverman (1982) p.194, "Far from providing resources for the French Treasury, the Ruhr occupation proved costly to the government and disastrous for the french franc, which soon sank to new lows."

[104] see Schuker (1976).

[105] Snowden, MacDonald's Chancellor of the Exchequer, was also opposed to reparations and Strong felt that they were too onerous. Schacht was opposed to the commercialisation of reparations.

[106] By commercialisation we mean the process whereby the German authorities would raise loans to meet reparations payments by selling bonds to private investors. This would transfer the reparations liability from an inter-governmental one to the privater sector,- hence commercialisation.

[107] Dr.Schacht had already received help from Montagu Norman in setting up the Golddiskontbank as Currency Commissioner, and when he became head of the Reichsbank he went straight to London to start negotiating with Montagu Norman for a permanent loan. Schacht got on well with Montagu Norman who was a germanophile, to the lasting resentment and suspicion of Moreau (cf., Schacht's memoirs (1955); and Boyle's (1967) biography of Montagu Norman). The Dawes loan ushered in a period of heavy capital inflow into Germany which provided her with the necessary foreign exchange to honour her reparations payments (see Schacht, 1955).

dominated the Reparations Commission, whose Chairman was French and had the casting vote. This was because the Reparations Commission had previously been empowered to declare whether Germany was in default or not. Poincaré had been Chairman of the Reparations Commission. This French objection gives us an insight into the political and diplomatic nature of reparations.

During May 1926 negotiations were under way between the French Ministry of Finance and, particularly, Morgan's for a loan to stabilize the franc. Germany had received a Morgan stabilisation loan. However, France's failure to arrive at a settlement of her inter-allied war debts prevented this, as well as her unbalanced budget and Governor Robineau's refusal to agree to allow the Bank of France's gold as collateral to secure the loan.[108] This and Robineau's construction programme were to be the cause of Robineau's dismissal by Caillaux and replacement by Moreau (a friend of Caillaux's). The rest of the pre-existing Morgan loan was transferred to the Bank of France when Poincaré returned to office. The balance in francs was credited to the Treasury account. The Treasury coffers had been empty and it was the government's only source of funds. In fact the Bank had only been willing to sell francs to the Treasury against receipt of the outstanding balances from the Morgan loan.

France was reluctant to have to face the burden of war debts on the grounds that the nation had suffered amongst the most during the conflict in terms of material destruction and loss of human life, and, as Keynes argued persuasively in one of his articles, "why shouldn't the other allies have to make financial sacrifice given France's sacrifices in kind?" However, it seems that Keynes failed to perceive the justified nature of France's related impatience with the British and American attitude towards reparations. The UK and US both condemned France for its reparations policy, but they failed to provide France with an Anglo-American security guarantee which may have contributed to this attitude and the US refused to renegotiate the principal on war debts due.

The World War Debt Funding Commission set up by Congress in 1922 was forbidden to reduce capital sums, but could negotiate on the basis of the interest. France, by sitting

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[108] The whole episode is treated more fully in Jeanneney (1976); and Chandler (1958). Similarly in January 1936 when the Treasury coffers were empty the Bank refused to pledge its gold as collateral for a £40 millions sterling loan (FRF 3bn.) raised by a syndicate of London banks (see Mouré 1991, pp.184-185; and chapter nine of this thesis).

it out, did achieve a less onerous settlement than the UK did. The UK reached an early agreement with the US as a settlement of its war debt liabilities was necessary for the return to gold convertibility and a stabilisation loan. Throughout this period, until the Hoover Moratorium and Standstill agreements, the US refused to recognise a link between war debts and reparations. That is, seemingly, why there was no official US participation at the Genoa Conference of 1922,[109] which laid the groundwork for the gold exchange standard. The French considered the gold exchange standard an attempt by the British to re-establish their financial hegemony, a view shared by Silverman.[110]

British policy towards war debts and reparations, characterized by the Balfour declaration of 1922, at first seemed to be more conciliatory. According to this Britain agreed not to ask more from her creditors than her creditors (the US) asked from her,- thus surrendering her net creditor position. Schuker (1976) has pointed out that France greatly resented this. For, given the US attitude, it implied that France would be obliged to honour its debt. It has been argued that the UK undertook this policy in an attempt to get the US to write off war debts. However, it set an unfavourable precedent, as it recognised the validity of the US's claim to war debts.

THE UK'S RETURN TO GOLD:

Britain's deflationary policies were meeting with success, in terms of the goal of reaching purchasing power parity with the US at the old dollar/sterling rate. However, this policy caused serious social strife, e.g., the 1921 coal strike. According to several estimates UK

[109] The groundwork for Genoa was laid at Cannes by Briand and Lloyd George (Dec. 1921/ Jan. 1922). A major goal of the Genoa Conference was to restore commercial ties with the Soviet Union to foster trade and promote British exports. A stumbling block was the question of Czarist debt which the Soviet Union refused to recognise unless the Allies were prepared to acknowledge a counterclaim (twice as large as that of the Allies) for war damage during the allied intervention in the Civil War. The Conference broke up after Germany and the Soviet Union signed the Rapallo Treaty (1922), which greatly antagonised the French as the signatories agreed to mutually cancel their debts, so long as the Soviet Union did not honour hers to any other of her creditors,- one should recall that France had been a major investor in Czarist Russia.

Briand and Lloyd George had attempted to secure US participation by calling for the conference on a personal level and not mediated through the auspices of the League.

[110] Quoting Silverman (1982) p.58, "It is difficult to avoid the conclusion that the gold-exchange standard was at least in part a scheme devised to restore Anglo-American hegemony over the international financial system."

prices were within 10% of p.p.p. with the US.[111] This policy was assisted by: controls and "moral suasion" exercised over British foreign lending which Montagu Norman operated through his network of City connections and the Capital Issues Committee;[112] the Ruhr occupation helped UK coal exports; interest rates were lowered in New York;[113] and, speculative upward pressure on sterling as the legislation suspending the gold standard was set to expire in December 1925.

Snowden, Ramsay MacDonald's Chancellor of the Exchequer, had appointed the Chamberlain/Bradbury Committee in June 1924 to consider the amalgamation of the currency and bank note issues. It also, inevitably, looked at the gold question.[114] The Committee recommended in Oct. 1924 an early return to gold. The recommendation was adopted by the new Chancellor, Winston Churchill, in April 1925. Churchill was far more hesitant about returning to pre-war gold parity than Snowden would have been,[115] though one should recall that a Labour government would be under more pressure to conform, as any unorthodox policy action on their part would be interpreted far less indulgently. In fact the return to gold, though opposed at the prevailing parity by Beaverbrook, Keynes and McKenna (a former Liberal Chancellor), was embraced by all parties, even exporting interests.[116] This general acceptance vitiates the argument that it was the self-serving act

[111] see Appendix for our own estimates which suggest that sterling was near parity against the dollar, but significantly over-valued against the franc.

[112] see Boyle's (1967) biography of Montagu Norman.

[113] Benjamin Strong had tried to convince the Fed. that the US should expand the money supply to raise the US price level to p.p.p. with the UK in this he failed, but he managed to lower interest rates in New York. This was not altogether altruistic as it helped foster New York's role as an alternative world capital market, and it also coincided with a downturn in US economic activity (see Clarke, 1967). Strong was again to reduce interest rates in New York in 1927 to take pressure off sterling in similar circumstances. French analysts were to blame the "credit inflation" of the 1920s and necessary adjustment, viz., depression, to easy money in the US and UK (see chapter ten of this thesis).

[114] Caillaux, in France, had proposed the *plafond unique* though different this did express a desire to set aside all illusions and to recognise the real monetary situation.

[115] see Churchill's *"circulaire"* and his dinner party, (see Moggridge, 1972).

[116] see Perrot (1955); and Chandler (1958) p.292, on the return to gold and the fact that it was supported, "by every British government during the period and by a majority of the members in every party in Parliament."

of a particular class represented by the Court of Directors of the Bank of England.[117]

To effect the return Norman arranged for a $200 million two year revolving credit from the F.R.B.N.Y. and a $100 million two year revolving credit from a syndicate headed by Morgan's, neither of which was drawn upon. Moggridge (1972) has extensively researched Britain's return to gold, and the following points emerge from his analysis,

1) the fear that, if Britain were not to return to gold before the wartime legislation expired, this could lead to a swift fall in sterling with inflationary consequences; 2) it was thought that US prices would rise and restore the old p.p.p./exchange rate relationship, in fact this did not occur; 3) wages were assumed to be more flexible than they turned out to be; 4) given the permanently altered structure of the British balance of payments (its reduced holdings and earnings on investment assets, and on invisibles due to shipping losses) in the long run the exchange rate would probably have proved untenable; 5) the exchange rate was considered in terms of p.p.p. with the US[118] and not with her other trading partners (i.e., a trade weighted index was not employed) and wholesale price indexes were used to calculate p.p.p. and given the "law" of one price this would tend to understate relative price differentials;[119] 6) Nurkse has argued that to have returned unilaterally was mistaken, however what emerges from this study is that there is very little evidence that any multilateral decision could have been endorsed,- the Genoa resolutions were never officially adopted.

More generally, the will to return to gold was a reflection of Montagu Norman's world view, that money should be independent of governments[120] (depoliticized) and

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[117] Prof. Susan Strange has brought to my attention (in conversation) the opinion of R.Boyce who argues that the City changed its mind when Labour came to office as the gold standard would act as a constraint upon socialist irresponsibility. However, that is a facile anti-establishment argument as Snowden was as orthodox as they come, *vide.*, his subsequent support for Ramsay MacDonald when Cabinet split in 1931 over cuts in unemployment relief.

[118] Though as the US was in fact the only country on a stable gold standard, and given its size relative to that of the world economy and the size of its gold stock, it was inevitable that the UK should use p.p.p. with the US as a benchmark.

[119] In the context of measuring relative French undervaluation in 1926, Sicsic (1992) rejects the use of wholesale price indices arguing that these are but a proxy for the exchange rate and that retail price indices should be used.

[120] On Montagu Norman's world view as perceived through French eyes see Moreau's memoirs (1954) pp.136-137.

managed by central bankers.[121] This vision was shared by his close friend Benjamin Strong, head of the Federal Reserve Bank of New York.[122] The French were particularly wary of Norman, Schacht and Strong.[123] In fact, reading Moreau's memoirs (1954) one gets the clear impression that Moreau objected to Norman's attempts at building a sterling exchange standard rather as de Gaulle was to object to the dollar exchange standard in the mid-1960s.[124]

Montagu Norman used the British capital market whose foreign lending he "controlled" via periodic direct controls and "moral suasion," as an instrument of British policy, that is to reconstruct Europe on a basis of sound currencies so that trade and foreign lending could pick-up again and consequently Britain's depressed export industries. This policy, it appears, conflicted with France's policy of trying to construct alliances on Germany's eastern frontiers which would in part be cemented by financial inducements, viz., foreign lending. Néré (1975) has tended to deny this thesis and Brogan (1945) supports it, but that there was a political perspective to these loans seems to be adequately borne out by the Rumanian stabilization loan negotiations and the relevant entries in Moreau's diary. Furthermore, it does seem that France's pre-war lending policy had not been free from foreign policy considerations,[125] particularly loans to Imperial Russia. Papers in the files of the Bank of France indicate that as far as Poland was concerned in the mid-1930s the *Quai d'Orsay* was keen that the Bank of France should continue to extend revolving credits to the Polish government. The Bank of France offered similar facilities to the Rumanian government and this cannot have passed without the knowledge of the French foreign policy establishment. It is also interesting to note that the Bank of France was encouraged by regents who were also industrialists to exercise leverage on Poland to extend purchases to French suppliers, viz., tied-aid. Stern (1929) has also underlined the tied nature of French

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[121] see Boyle (1967).

[122] see Chandler (1958).

[123] see Moreau (1954).

[124] see Moreau (1954) pp.488-489, which underline the French perception of British objectives as being in effect determined by imperialism under the guise of *laissez-faire*. It also reveals the political nature of France's foreign lending policy. Note that the conversation recorded in these pages took place with the then *président du conseil* (Prime Minister), Poincaré.

[125] see Feis (1974).

lending and capital issues floated on the Paris market.[126]

Moreau in his memoirs decried British control over the Financial Committee of the League of Nations, which administered League of Nations post-war reconstruction loans. Strakosch was a leading light on the Committee and was to become one of the most vocal critics of France's gold hoarding.[127] Furthermore, Montagu Norman's support had been of great importance in securing the success of the League loans to Hungary, Austria and the floating of the Dawes loan.

This section has attempted to demonstrate that France's financial policy, particularly in the early post-war period cannot be divorced from the international context and France's security preoccupations. Nor can one ignore the domestic political pressure to ensure that Germany should pay before charging the French tax payer for the costs of reconstruction. This had immediate consequences for the French budget,[128] as a significant proportion had to be financed through borrowing and printing money, against what was a most uncertain asset, viz., German reparations liabilities. This part explains France's protracted financial and budgetary crisis from the immediate post-war period until the advent of Poincaré in 1926. It also helps understand why Britain's experience was so different as the return to "normalcy" was not built on similar illusions which so contributed to France's budgetary vicissitudes. The UK did not have to fund substantial reconstruction expenditure either.

THE CARTEL DES GAUCHES' FINANCIAL DEBACLE 1924-26:

Prior to Herriot's advent to power, governments had resorted to covert advances from the Bank to the government through the medium of commercial banks. This was to avoid allowing the ceiling on direct advances from the Bank to the government being breached.

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[126] Quoting Stern (1929), "The creation of railways, canals, harbors, etc., in foreign countries with the financial support of foreign enterprises by French capital or engineering concerns, has been a source of profit for French foreign commerce. This has resulted in large orders to French industry, under the active pressure of French governmental representatives in foreign countries and with the intimate cooperation of the competent authorities at home who have been interested in seeing that the issue of the respective loans and their introduction on the Paris Stock Exchange subject to French commercial interests was safeguarded in this respect." p.73.

[127] see chapter ten of this thesis.

[128] see chapter four of this thesis.

This would work as long as the note circulation remained below its ceiling. Basically commercial banks discounted government paper which was later rediscounted by the central bank. These are referred to in the French literature as "*avances occultes.*" This policy helped increase the marketability of government debt, though it also suggested its monetisation. It had the psychological effect of keeping within the spirit of the François-Marsal convention. Eichengreen points out, in reference, to these indirect advances, that, "What were in effect advances from the central bank to the Treasury thereby appeared in the Bank of France's statement under "portfolio" rather than "advances to the State."[129]

However, this policy could not be resorted to once the Bank had hit the limit set by the ceiling on the note issue. So a complex scheme was devised by Albert Aupetit, Governor Robineau's *Secrétaire Général* of the Bank, to reduce the apparent size of the note issue in the financial statements of the Bank of France,- hence, the episode of the "*faux bilan*" (doctored balance-sheet of the Bank of France!). The procedure was to double count both notes in transit between branches of the Bank of France and the notes that were periodically destroyed, sums being in turn deducted from the sum total of the note circulation. He was able to disguise the fact because of time lags in the system used for recording these movements, the whole process is well recounted in Jeanneney (1977).[130]

Apparently only Robineau, and Aupetit and *sous-Gouverneur* Leclerc were aware of this, at first, but the interesting fact that comes out of Jeanneney's study is that the procedure had been initiated on March 13th 1924, before Herriot assumed office. These methods had begun under Poincaré's premiership (15/1/22-26/3/24).[131] However, this practice had previously occurred only to a limited extent. Under Herriot, the underestimates got larger and eventually on 18th Dec. 1924 Robineau revealed the exercise to the *Conseil de Régence*, - the governing board of the Bank of France. Herriot's government was now at the mercy of the Conseil which harboured some implacable enemies of the Radicals, foremost amongst which was de Wendel, a *député* and head of the *Comité des Forges*, and member of the *Fédération Républicaine*. Surprisingly the Regents went along with the "*faux-bilan*," for a while, hoping that the government would somehow manage to reduce the note circulation or

[129] see Golden Fetters, p.179, footnote 61.

[130] Jeanneney (1976) pp.209-11.

[131] Jeanneney (1976) p.202.

regularise the process by raising the ceilings, but Herriot would not raise the ceiling to the note issue; being adamantly opposed to inflation! Jeanneney argues that the Regents played along with the "faux-bilan" to avoid a further weakening of the franc which was again falling on the exchanges and because one of the Regents, the highly influential Edouard de Rothschild evinced some sympathy for the Radicals' cause. The episode became common knowledge after Herriot had informed a parliamentary financial committee. It was made public in April 1925 and Herriot's ministry fell shortly thereafter. The situation was eventually regularised by raising the ceilings immediately after the fall of the Herriot government.[132] Thereafter both ceilings were raised periodically, which contributed to the exchange crisis of 1926.

Herriot chose to fall on the issue of the capital levy, thus further exploiting the legend of a "*mur d'argent*" which had supposedly been instrumental in overthrowing him. This explains the subsequent demand by the Popular Front that the statutes of the Bank of France be altered so that it could become the "*Banque de la France.*" However, as Peel (1937) has pointed out it was the governments themselves which had placed themselves in such a position, though Peel could have been more indulgent towards the *Cartel* which inherited a particularly acute treasury position.

Herriot appears to have played a rather deceitful game with his Finance Minister, Clémentel during this crisis. Clémentel opposed the capital levy and had been under the impression that government policy was to ask parliament to raise the ceiling on the note issue. Herriot contradicted him in the Chamber of Deputies, stating that his government would seek a capital levy instead of an inflationary rise in the note issue. Clémentel resigned to be replaced by de Monzie. It is generally thought that Herriot chose to fall to the left as he no longer enjoyed a majority,[133] and the capital levy proved a suitable vehicle.

Herriot's error, with hindsight, seems to have been to have failed to accept the recommendations of de Moüy's report.[134] De Moüy was then head of the *Mouvement Général des Fonds*, now known as the *Trésor*. He had recommended raising the "*double plafond*" and abrogating the François-Marsal convention. Accepting it would certainly have

[132] Jeanneney (1976) p.274.

[133] see Eichengreen Golden Fetters, p.181.

[134] de Moüy's report was pub. 27th June, 1924.

avoided the domestic political repercussions of the "*faux-bilan*," but it would probably have triggered an exchange crisis. Given the financial situation and the fiscal impasse discarding the "*double décime*," and not raising or revoking the "*double plafond*" was tantamount to committing political suicide.

This episode is important in that it reveals how the "*règles de plafond*" could contribute to inflationary expectations. Jeanneney stressed the importance of the ceiling on the note circulation and the French franc dollar exchange rate to contemporary opinion, viz., expectations. The "*règles de plafond*" were abolished under the provisions of Poincaré's 1928 monetary law.

Robineau and Aupetit were dismissed by Caillaux, when he became Minister of Finance in 1926, the reasons being the episode with the "*faux-bilan*" and Robinau's previous unwillingness to pledge the gold of the Bank of France as collateral for a stabilisation loan for the franc.[135] The "*valses des Gouverneurs*"[136] who were political appointees, had begun.[137] Moreau was appointed to replace him with C.Rist as his *deuxième Sous-Gouverneur*. Caillaux was later to claim that he had dismissed Robineau because of his extensive building programme.[138]

In 1926 France finally settled her inter-allied war debts with the Mellon/Bérenger accord of 27th April 1926 and Churchill/Caillaux accord of 12th July 1926,- though it took three years for parliament to ratify them.[139] De Wendel had opposed the inter-allied debt settlements.[140] In fact they were not ratified by Parliament until the Young Plan.[141] This

[135] cf. press clippings in the Bank of France file on Robineau (article by Strohl).

[136] It appears from press clippings in the file on Robineau at the Bank of France, that, since Nov. 20th 1925, Poincaré had attempted to replace Robineau by Charles Chaumet then Minister of Commerce!! However, the Regents threatened to resign *en masse* and the government desisted.

[137] The previous Governor Pallain had governed from 1897-1920. The tenure of Governors was to become progressively shorter as governments increasingly made their own appointments,- though this can be overstated (see Appendix). In the UK a greater degree of continuity was provided during the inter-war period with Montagu Norman, holding the Governorship from 1920-44,- breaking with the tradition that Governors should only be appointed for two year periods.

[138] see Mouré (1991); and B.F., *Archives Gouverneurs*.

[139] see Bernard & Dubief (1985).

[140] see Jeanneney (1976).

[141] see Néré (1975).

would make it appear politically more palatable, as it would seem that Germany would be the ultimate payor. This was a necessary prelude to stabilizing the franc. The French authorities were obliged to reach an accord or they would have had to pay in full a debt of $400 million falling due. This was the counter-part to surplus US stock sold to the French government at the end of the war. Congress had forbidden loans to governments which had failed to settle war debts. War debt payments ceased in 1932 when Herriot's proposal that payments be continued were rejected by parliament. Following the unilateral Hoover moratorium which suspended reparations payments (the counterpart of France's war debt liabilities) the French parliament was in no mood to continue its payments to the US. In this instance it is likely that Herriot acted as the fall guy, knowing that his government was doomed and that parliament would not endorse continuing war debt repayments after the Hoover moratorium. At least the French government could pretend to have made an effort to meet its liabilities to the US.

THE POINCARÉ STABILISATION 1926-1929:

The implementation of the Poincaré stabilisation was based on the Sergent committee report. Haig has pointed out that the left were not favourable to the Committee of Experts' report (the Sergent Committee report) and Jèze who was a member refused to endorse it.[142] The left undoubtedly objected to the recommendation in the report which favoured a rise in indirect taxation, such a measure would ensure that fiscal revenue would be indexed to the price level.

1926 had witnessed increased speculation against the franc and Poincaré was called to form a government of National Union. His government included six former premiers and encompassed the whole political spectrum, bar the "marxist" parties, viz., the socialists and communists. The franc immediately picked up as speculators worked on the belief of a return to gold and possibly to par,[143] to which Poincaré (a lawyer) was favourable. Poincaré raised the discount rate to 7.5%, which was exceedingly high for the period.

In this context most observers have stressed the psychological effect of Poincaré's

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[142] Haig (1929) p.151.

[143] France had suspended gold convertibility on Aug. 5th, 1914.

advent to power in helping raise the franc on the exchanges particularly as his name was associated with the successful "bear squeeze" of 1924;[144] but other factors must include the large parliamentary majority that the government coalition of *Union Nationale* commanded; the collapse of the *Cartel*; and the "real" measures that followed,[145] such as the announced aim of balancing the budget and measures taken to that effect. Following the meeting at Versailles, for symbolic purposes, of both chambers, the *Caisse Autonome d'Amortissement* was established, by constitutional amendment, to redeem and support the *bons de la Défense nationale*, - and hence the state's credit. It drew its resources mainly from the revenues from the state tobacco monopoly and the death duty. This induced confidence as it put paid to the possibility of a forced conversion.[146] The issue of very short term debt was also reduced.[147] The aim being to lengthen the maturity of the debt, to make it more manageable and to allow a debt conversion at a later date, when confidence had returned. A debt conversion operation was held in 1932.[148] The creation of the "*Caisse*" was of particular importance as its gradual consolidation of short-dated paper made it easier for government to regain control over the money supply, previously if confidence was shaken and short-dated bills not renewed the only route open to government was to monetise the ensuing deficit.

One should not disregard the accompanying fiscal measures which lent the programme credibility. The budget was passed before the financial year was out (an innovation in itself!) and included revenue raising measures[149] such as increases in indirect taxes as well as a 7% tax on transfers of real estate,- the latter measure was probably a sop to the radical-socialists in government, a *quid pro quo* for agreement to indirect tax rises. The budgetary

[144] Quoting Perrot (1955) p.188, "*C'est cette croyance un peu naïve au pouvoir magique qu'ont les hommes politiques d'aggraver ou de redresser la situation monétaire qui, en quelques jours, a failli miner, puis a sauvé la monnaie nationale,*" and again p.190, "*La politique financière de R.Poincaré a été toute entière fondée sur l'importance des facteurs psychologiques en matière monétaire. L'opinion française croyait encore, selon la doctrine libérale, au rééquilibre spontané en matière monétaire. Le revirement s'est donc produit.*"

[145] see Sargent (1983).

[146] see Rueff (1980) vol.2, p.350; and Goguel (1937).

[147] Sédillot (1953) p.271.

[148] see Mouré (1991).

[149] see chapter four of this thesis.

measures also halving the top marginal rate of income tax from the very high rate of 60% to 30%. This time round, unlike 1924, Poincaré did not introduce a *bordereau de coupon*. The absence from the fiscal package of a tax on income from bonds and the sharp reduction in the top marginal rate of tax undoubtedly increased confidence.

Blum bungled his devaluation in September 1936 by attempting to tax profits realised on gold holdings held by domestic residents and introducing a tax on profits realised on foreign exchange operations. This measure threw away one of the benefits of devaluation, viz., the repatriation of capital which translates into higher foreign exchange holdings as "speculators" seek to realise profits.

Kemp (1972) has argued that the "psychological" effect on confidence of the Poincaré stabilisation is more significant than "real" factors. "The political and class aspect of the changes made by Poincaré after becoming premier on 24th July 1926 was more important fundamentally than the fiscal and monetary measures which he began to take. Within a few days a series of tax reforms was made. The advances of the Bank of France to the state were reduced, although in fact this was offset by an increase in the discounting of government paper. The joint session of the Chambers at Versailles established a *caisse de gestion des bons* which set an upper limit to the amount of short-dated securities and separated them from the general treasury account. The proceeds of the tobacco monopoly were put at its disposal, as well as certain other receipts."[150] This "psychological" thesis undoubtedly gained ground because of the rapid appreciation of the franc.[151]

Experience in the 1980s clearly demonstrates that exchange over- and under-shooting and exchange and domestic "bubbles" can be quite long lasted followed by rapid adjustment, though capital markets are far more integrated today. That does not mean that they are any less "rational." And as Eichengreen has clearly demonstrated the nature of Poincaré's coalition government was the political manifestation of a fiscal compromise which rejected measures such as a capital levy or forced conversion. The breadth of the coalition, Poincaré himself, and the grant of decree-making powers lent credibility to the government. These reasons are just as real as any explicit fiscal measures. Therefore to suggest that market sentiment was previously irrational only betrays a dislike and lack of understanding of the

[150] Kemp (1972) p.80.

[151] see Sicsic (1992).

market process.

Legislation was also passed allowing the Bank of France to purchase foreign exchange and gold at the market rate and to issue francs against these assets over and above the ceiling on the note issue (i.e., France had, for a while, legally adopted a gold exchange standard).[152] This policy allowed the Bank of France to manage the currency and in effect prevent its appreciation. All currency issued above the stipulated ceiling would have to be 100% backed by foreign currency, acquired as its counter-part. Notes issued under these circumstances would thus be fully-backed "outside money" and hence confidence in the note issue would be retained, despite an increase in its supply. The substantial foreign exchange reserves which the Bank of France obtained by this means would allow the authorities in 1928 to *de jure* stabilise without a foreign loan.

Issuing 100% fully backed "outside" money allowed the authorities to supply the market demand for additional real cash balances (see Hawtrey), avoiding an appreciation of the exchange rate and a rekindling of inflationary fears which the issue of unbacked currency might precipitate (see Friedman).

France's reserves of foreign exchange swelled as capital flowed back and the franc appreciated. On the 22nd Dec. 1926 the French government's representative on the *Bourse*

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[152] The legislation is quoted in Sédillot (1953) p.272. In this context Sargent (1983) has argued to the effect that the "psychological" explanation of the successful stabilisation can be attributed to rational expectations. He argues that a definite and credible change of regime had occurred, viz., the *Caisse Autonome d'Amortissement* was set up via a constitutional amendment and the governor of the Bank of France evinced far greater independence from political pressure than his predecessor had. Though the latter suggestion is hard to accept given Robineau's reluctance to pledge the Bank of France's gold,- one should note that Moreau was Caillaux's appointee and that whenever Poincaré met Moreau he was accompanied by Moret (see Moreau's memoirs), then head of the *Mouvement Général des Fonds* (Treasury), who later succeeded Moreau as governor,- it is therefore probably incorrect to suggest that Moreau was any different from other governors. Even Tannery who replaced Moret, and was considered more pliant insisted, that Flandin's request for Treasury bill rediscount facilities in May 1935 (the government was in a full blown crisis following the Belgian devaluation in March, and results of Municipal elections which pointed to a Popular Front electoral victory in the elections to the Chamber of Deputies to be held in May 1936) be accompanied by a request for decree-making financial powers to "effect expenditure reductions" this request which signalled a policy U-turn was refused and Flandin resigned - see Mouré (1991) p.177; Poincaré had a large majority and his cabinet comprised five ex-Prime Ministers; and he managed to raise taxes. Furthermore, the 1927 budget had been passed in record time (see Moreau, 1954). Sargent has also argued that, although, the money supply increased people were willing to hold the additional currency as it was, at the margin, fully backed "outside" money issued against newly acquired foreign exchange and gold reserves.

Sargent recognises that the stabilisation and the increased willingness to hold francs could also be explained by the fact that the discounted value of government debt, i.e., notes outstanding and government paper, had increased given the rise in taxes. This reduced uncertainty caused by unbalanced budgets and answered the concern over the future financing of government expenditure and by analogy the value of outstanding government debt. The latter explanation is in line with the Ricardo/Barro equivalence theorem.

announced that the government would purchase and sell sterling at a rate of 122.25 francs. This decision, one supposes, was prompted by a desire to stem the capital inflow which made control of the money supply increasingly difficult, and in order to maintain France's competitiveness.[153] This ushered in the period of *de facto* stabilization which lasted till 25th June, 1928. From then-on it appears clear that the rate announced would become the *de jure* rate as any higher exchange rate would have involved paper losses for the Bank of France on its foreign exchange purchases. The fixed currency peg provided an expectational anchor and a clear and visible test of the government's success in maitaining monetary stability.

The question of the rate at which the franc was stabilised, and its undervaluation, would be the subject of continued debate.[154] Sicsic (1992) characterises these two rival opinions as those of Sayers (1976), who argued that it was deliberate, and Wolfe (1951) who saw no evidence of this. Eichengreen (Golden Fetters) is also of the opinion that there is no evidence of a deliberate attempt at maintaining an undervalued parity. Though one should recall that Rueff was asked to prepare a paper on the real exchange rate of the franc against the Reichmark, and that the leader of the C.G.T., Léon Jouhaux, was worried in case of loss of competitiveness should the franc appreciate further. Sicsic does not take into consideration the question of the increased real debt burden which must have weighed in considering the rate at which the franc would be stabilised.[155] Sicsic has argued that the authorities were not aware of the significant undervaluation of the franc, in part because those who did attempt to calculate relative purchasing power parities used wholesale price indices, e.g., Quesnay of the Bank of France.

Sicsic has argued that the wholesale price index acts as a proxy for the exchange rate and tends to significantly underestimate the degree of undervaluation. Sicsic points out that Rueff calculated parity on the basis of both a wholesale and retail index using German price indices. Sicsic states that Rueff had established a purchasing parity of 120 using retail prices and 145 using a wholesale price index (the pound was then trading at 130 francs). Sicsic later suggests that Rueff obtained a French franc/sterling parity of 105 francs using relative

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[153] see Sicsic (1992).

[154] see chapter ten of this thesis.

[155] see Eichengreen & Wyplocz (1986).

German and French retail price indices, but dismissed the results because the French price index was too narrowly defined.[156] Sicsic is similarly critical of Eichengreen's use of a wholesale price index to calculate the level of franc undervaluation. According to Sicsic the rate of undervaluation was more than 25% (using retail price indices) rather than the 5-10% suggested by wholesale price indices.[157]

Sicsic argues that the French authorities acted in 1926 to avoid a further (destabilising) appreciation of the franc, but that it was not prejudged that this would be the final rate adopted. However, as Sicsic himself admits any revaluation above the rate chosen in 1926 would have involved the Bank of France in substantial foreign exchange losses and not been without "real" adjustment costs.

Sicsic's thesis aims to prove that speculative pressures were destabilising hence the need to announce a fixed purchase price for foreign exchange in order to avoid a sharp appreciation of the franc. He contrasts his analysis with Eichengreen's who has attempted to construct a counter-factual to demonstrate that speculation was "stabilising" and Sargent's argument that it reflected a change in market expectations. Sicsic criticises Eichengreen's data and argues that the latter's thesis, viz., that speculation was not destabilising, is not proved. Sicsic's view is that contemporary fears over "hot money" flows cannot therefore be dismissed and that this explains the behaviour of the French financial authorities.

Sicsic (1992) suggests that there was a continuum in policy from Poincaré's government in 1924 through the *Cartel* to July 1926 when Poincaré formed his government of *Union Nationale* suggesting by inference that it was a shift in confidence rather than any change in real measures which played a significant role in the franc's volatility.[158] Sicsic's suggestion here is clearly preposterous, the *Cartel* abandoned the "*double décime*", and the "*borderau de coupons*," they also suggested that they might abolish the business turnover tax (*taxe sur le chiffre d'affaires*) considered responsible for the high cost of living and were supported by the socialists who favoured a capital levy! Without engaging in any sophisticated econometric analysis one might wonder, "if not because of "real" factors whence the change in confidence?" One should recall Dulles' judgment "The conclusion

[156] see Sicsic (1992) pp.76 & 89.

[157] see Appendix for my own estimates.

[158] Sicsic (1992) p.70, footnote 1.

resulting from the study just outlined is that confidence was the principal short-run determinant value of the franc. This emphasis on psychological factors should not lead either to skepticism or to inertia in the attempt to control financial forces."[159]

In Feb. 1927 Norman went to Paris. The French wanted to re-negotiate a Franco-British debt originally contracted in London in 1916 to support the franc, which had been renewed in 1923. The terms on which this debt had been contracted now appeared too onerous (perhaps the newly acquired financial power of the Bank of France also contributed to this demand), the loan had been secured on a deposit of gold at the Bank of England worth £150 millions sterling. Moreau would eventually repay the loan in advance in a pique. The importance of this incident is that it most probably increased the animosity and distrust between Montagu Norman and Moreau.[160]

During early 1927 the Bank of France increasingly drew gold from London. This put pressure on sterling. The French argued that they were only drawing newly mined South African gold. However, this would still reduce potential world base or reserve money. They had to draw gold to help stem the upward speculative pressure on the franc which was potentially inflationary. The Bank of France issued francs against these newly acquired assets,[161] thus holding it down on the exchanges. The Bank of France hoped that thereby Norman would be forced to raise bank rate,- Moreau also wanted Schacht to raise the German discount rate. This precipitated Montagu Norman's visit to Paris at the end of May 1927 at which Moreau argued that the Bank of England should raise bank rate. Montagu Norman was reluctant to do this because it would worsen the industrial depression so soon after the coal and general strikes of 1926. Montagu Norman argued that the French should lower their interest rates, modify the law to allow capital exports (capital export controls were lifted in 1928) and declare that the franc would not be allowed to rise any further.[162] Nothing really came of this meeting, but in June Benjamin Strong relieved pressure on

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[159] Dulles (1929) p.52 - not underlined in the original. Eichengreen (1992) has added a critical "Comment" to Sicsic's paper.

[160] Chandler (1958) p.374; and Moreau (1954) pp.251-254.

[161] see Rueff; & Kindleberger.

[162] Chandler (1958) p.374.

London by selling gold to the Bank of France at its London price.[163] The Federal Reserve Bank of New York was thus effectively subsidising French gold imports by the cost of shipping gold from New York to London.

In July 1927 Norman, Rist (representing Moreau,- who could not speak English), Schacht and Strong met to deal with the strains on the international monetary system. The end result was that Strong reduced interest rates in New York taking pressure off sterling and so did Schacht, and both Paris and Berlin drew gold from New York. This was facilitated by the need to reduce interest rates in the US for domestic economic considerations. This was the last time that independent central banks were to arrive at a mutual agreement to stabilize the international monetary system during the inter-war period, till the Tripartite Agreement in 1936.

On 25th June 1928, following a general election which proved a success for Poincaré, *de jure* stabilisation was achieved at a fifth of pre-war parity - Rueff has argued that the labour leader Léon Jouhaux, who was head of the C.G.T., was instrumental in convincing Poincaré that this was the correct solution.[164] As a revaluation from the *de facto* rate of exchange against sterling would bear significant costs. Poincaré apparently favoured the more legalistic policy of restoring the franc to its pre-war parity,- as had Robineau. Some have argued that Poincaré had already been convinced of the impossibility of a return to pre-war parity, but that he had to placate his own constituency. Restoration to pre-war parity would have meant such an increase in the relative debt burden and such a deflationary policy that he was dissuaded. The Poincaré franc was worth 20% of the *Germinal* franc's gold value, its value had been reduced from 322.58 mmg. to 65.5 mmg. at 9/10ths fine.[165] The gold value of outstanding French franc debt had therefore been reduced by 80%, at the stroke of a pen.

Moreau sympathised with Poincaré's avowed desire to pre-war par, but realised the political and economic impossibility of such a policy and influenced Poincaré. Moreau

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[163] Chandler (1958) p.375.

[164] In Rueff's preface to Moreau's Memoirs (1954), referring to the role of the C.G.T. Léon Jouhaux, he states, "*M.Rist m'a affirmé qu'ils* (refers to his evidence) *avaient été le facteur décisif dans le succès final des démarches de M.Moreau,*" that is *vis-à-vis* Poincaré (p.IX). Further-on Rueff adds pithily, p.XIV, "*Qui veut faire une politique réaliste de prospérité et de paix sociale doit reconnaître le niveau existant des salaires comme le plancher immuable de toute politique financière constructive.*" This sounds rather Keynesian!

[165] see Sédillot (1953).

records in his memoirs (1954) that he eventually threatened to resign unless Poincaré made up his mind and decided to return to gold convertibility. Large capital inflows were making it difficult to control the money supply, given the exchange peg which prevailed. The policy strategy adopted by Poincaré was influenced by the 1926 Sergent Committee Report (1926) of which Moreau, Rist and Rueff were members.[166] The committee had been appointed by Raoul Péret, Finance Minister in the Briand government of 9/3/26-15/6/26.

In a sense the debt burden left-over from the war was a boon, in that it made it really impossible for France to seriously contemplate returning to the franc of the *AN XI* (1803), the *franc de Germinal*; whilst the UK had returned to the gold parity of 1717 set by the Master of the Mint, Sir Isaac Newton. This implied that the UK had to control, either officially or by means of "moral suasion" foreign issues on its capital market and had to maintain interest rates above those prevailing in New York, which imparted a deflationary bias to the UK economy. The over-valued sterling exchange rate also meant that the UK imported deflation across the exchanges. High domestic interest rates and depressed economic activity would reduce expenditure-switching from the traded goods to the non-traded goods sector and nominal wage illusion would reduce corrective "real balance effects", i.e., workers would not perceive the extent of real wage gain. Sauvy argues that this was the case in France when civil servants objected to decreed cuts in salaries in the mid 1930s whilst in fact their real salaries were at all time highs. One should also note that real balance effects would be offset by the advantage of holding cash balances, and nominal wage, and price (in particular retail price) rigidity would hamper market clearing, and structural rigidities would hamper supply-side adjustment in the depressed export-oriented sector of the economy. The orthodox thesis and supply-siders ignore market rigidities which impair adjustment. We will see that France's experience from 1931 onwards was to prove rather similar to the UK's during the early post-war period.

If one reads Norman's evidence before the Macmillan Committee,- some of whose remarks are quite astounding,-[167] one finds that he rejected the argument that the UK suffered from high unemployment due to high interest rates, but that it was rather due to

[166] Poincaré largely followed the recommendations of the Sergent Committee in stabilizing the franc. For the recommendations of the Committee see pp.14-17 of Moreau's memoirs (1954).

[167] see questions 9173 to 9175 of Norman's evidence before the Macmillan Committee on pp.240-41 in, Sayers (1976), Appendixes.

structural maladjustments, in particular in the traditional export sectors. He accordingly supported the creation of two financial institutions to finance the rationalization of industry,[168] viz., "The Securities Management Trust" in Nov. 1929, and "The Bankers' Industrial Development Company" in April 1930.

The *de jure* stabilisation of the franc was accompanied by a major reform of the French financial system, which has been blamed for the subsequent instability of the international financial regime. The "*règles de plafond*" were abolished and the Bank of France was now to operate within a more "politically neutral" framework, viz., within a fractional reserve system.[169] The note issue and deposits at the Bank of France were now to be covered by a 35% gold reserve ratio. The Bank of France was no longer empowered to hold foreign exchange above the level of its existing holdings as reserves.

Before examining British objections to this policy switch, one should reiterate a point regarding the rate at which the franc was stabilized. It has often been contended that the rate at which the franc was stabilized undervalued it, given the p.p.p./ratio which then prevailed.[170] On this assumption, it was a form of beggar-my-neighbour policy.[171] However, one must bear in mind the increased internal debt burden which would have accompanied a higher exchange parity. Though the question of relative purchasing power and international competitiveness did come into the equation and Rueff was consulted on the question, the decision was also dictated by the real domestic debt burden associated with any particular franc gold parity. This consideration is missing from the contemporary British and US critiques of French stabilisation. A return to pre-war par was considered just too onerous a burden to bear. According to Sauvy's estimates for government debt and nominal national income the government debt/national income ratio still stood at 1.2 in 1928.[172]

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[168] Rationalization was the buzzword of the 1930s and was resorted to, in varying degrees, in France, the UK and the US. In France Flandin tried to promote cartelisation in highly concentrated industries (Jackson, 1985).

[169] Previously the *plafonds* could be raised by parliamentary vote. The reform in effect made monetary policy independent.

[170] see Sauvy 1984; Sicsic 1992; and Appendix. These estimates assume equilibrium in 1913.

[171] see Sayers,- quoted by Sicsic (1992).

[172] Sources: Sauvy (1984) vol.2, p.297; vol.3 p.16. The stabilisation exchange parity yielded a sterling rate of 124.213 (Sédillot 1953, p.280) if the authorities had stabilised at a rate of say 100 francs, an appreciation of some 19.5%, and one assumes the law of one price (McCloskey & Zecher, 1984) this would have increased

FRANCE AND THE INTER-WAR GOLD STANDARD:

British economists such as Hawtrey,- Director of the Financial Enquiries section of the Treasury and one of the architects of the Cunliffe Committee and of the Genoa system,- vigorously condemned the ensuing French policy.[173] France was accused of hoarding gold. This maldistribution of gold concentrated in New York and Paris was one of the major explanations for the unstable nature of the inter-war international monetary system, current at the time.[174] It was believed that France and the US sterilized gold and, therefore, restricted the level of world liquidity. Their combined reserves as a proportion of total world gold reserves accounted for circa 52% in 1927; 59% in 1933; and 64% in 1935.[175] The Bank of France's foreign exchange holdings fell dramatically during this period and its gold reserves increased virtually *pari passu*, sterilising international liquidity.

It is also interesting to note the gold cover ratio recorded in Sédillot.[176] On the 28th June 1928, the date of the Poincaré stabilisation this stood at 40%, rising steadily through the "gold avalanche" years to a peak of 80% at end 1934 declining to 54% on the eve of devaluation on 25th September 1936. Sédillot's figures show that on the eve of devaluation the gold reserve stood at 50.1bn. Poincaré francs. That is at a level which was considered the minimal "war chest." The figures for the volume of gold reserves in tons of fine gold

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the debt burden by 23% of national income (using Sauvy's estimates of national income and national debt). This exercise is not meant to be accurate, but only to demonstrate the significant additional burden of government debt which would have to be borne if a higher exchange parity had been chosen. Of course one might retort that assets and liabilities must match and that either an increase or fall in the real value of outstanding public debt (and or higher taxes) would not affect aggregate national wealth. However, the crowding-out of capital markets which this additional debt would have imposed should not be ignored. It would have increased the fiscal burden on the "active" side of the economy. In the existing circumstances it would have led to a further monetisation of the debt and exacerbated exchange crises.

[173] Quoting Hawtrey (1933), "The event which gave the signal for general deflation in 1929 was the change of policy on the part of the Bank of France, which ceased to buy foreign exchange, disposed of 6 milliards of foreign assets it already held, and began to absorb gold at the rate of 10 milliards in a year. It was the reversal of the previous adherence to the gold exchange standard in one important case that disturbed a pre-existing equilibrium." p.218.

[174] For a French perspective on the causes of the so-called "gold avalanche" see Aftalion (1930); and chapter ten.

[175] see Eichengreen Golden Fetters, table 7:1 p.192, figures used are in millions of US dollars of constant 1929 gold content.

[176] Sédillot (1953) p.284 & p.290.

are also very telling. On 25/6/28 these stood at 1,709 tons, peaking at 4,910 tons in November 1932, declining steadily to 2,950 tons on 25/9/36.

Sauvy[177] gives the following figures (year averages in millions of francs) for foreign exchange and gold held at the Bank of France:

	1928*	1929	1930	1931	1932	1933
for'ex.	31,549	27,215	25,686	25,488	8,960	3,087
gold	30,652	37,011	45,911	58,966	79,481	80,980

	1934	1935	1936	1937	1938	1939
for'ex.	834	961	1,303	1,041	799	517
gold	78,958	74,976	60,129	56,612	n.a.	92,939

* second half 1928.

The Genoa system was never formally endorsed but had become so *de facto*. It recommended a gold exchange standard based on two key currencies, viz., sterling and the dollar in order to avoid a deflationary scramble for gold.[178] This was in accordance with arguments adduced by Cassel and Hawtrey. This meant, in effect, that the UK and the US regulated the level of world reserves, the world money supply and would be the main world capital markets with the attendant financial leverage and political influence. This is certainly the interpretation which many French policy-makers put on it.[179] Kindleberger and Rueff have argued that this made for an unstable international financial structure, funds could be switched from one centre to another and more importantly with the gradual collapse of the gold exchange standard in 1931, as countries dishoarded foreign exchange and drew gold, the level of world liquidity fell.[180]

Kindleberger rests his analysis on an interpretation of the gold standard which ascribes

[177] Sauvy (1984) vol.III, p.393.

[178] Gold was also to be economised by withdrawing it from circulation and replacing it by notes. Gold would now only be used to regulate level of world liquidity and to effect international settlements.

[179] see Moreau (1954).

[180] see Nurkse (1944).

a key stabilising role to sterling in the pre-war world, failure on the part of the US to act as a stabilising hegemon is then adduced as the principal cause of inter-war currency instability. However, one should be wary of transposing experience from a previous regime to the quite different international circumstances which prevailed in the post-bellum world. Eichengreen has argued that the hegemonic stability thesis has been over-played and that currency regimes have always been characterised by a considerable amount of co-operation, that the latter was lacking during the greater part of the inter-war years no-one would dispute.

French analysts (q.v. Rueff) argued that a system which ascribed a key currency role to sterling would allow the UK to avoid domestic economic adjustment by forcing countries on a gold-exchange standard to absorb sterling liabilities and that this was intrinsically inflationary. However, a seldom noted, arguably, beneficial effect of such a regime is that it attenuates the deflationary asymmetry of the balance of payments adjustment mechanism which, in practice (*pace* the traditional 19th century text-book adjustment mechanism,- cf., Hume), places the burden of adjustment on the country running a deficit on current account. Under a "hegemonic" currency regime absorption of key currency reserves will expand the money supply of the surplus country and smooth the adjustment mechanism. However, during the inter-war years the problem lay in the fact that the US was running a current account surplus and failed to recycle international liquidity, viz., gold,- unlike during the 1960s. One should note that though Rueff and Kindleberger both argue that the inter-war financial system was unstable their respective prescriptive remedies differed radically, viz., the former arguing for a tightening of policy in the US and UK whilst the latter is of the opinion that the US should have eased credit conditions and lent contra-cyclically. Their rival prescriptive policies are, in part, due to a radically different interpretation of the working of the 19th century gold standard.[181]

France's foreign exchange balances were understandably significantly reduced following the devaluation of sterling. France had suffered extensive exchange losses on its sterling balances, belying the contention that it had deliberately undermined sterling. It has also been averred by Rueff, and Austrian (v.Mises and v.Hayek), and the neo-Austrian economist Rothbard (1983), that the gold exchange standard led to a pyramiding of credit particularly on the weak gold base of the Bank of England. Kindleberger has argued that the

[181] see chapter two of this thesis.

pre-war system had been centred, primarily, on London, which lent in a contra-cyclical fashion smoothing over the international business cycle.[182]

According to this interpretation of the gold standard in the pre-war system a rise in bank rate acted in a stabilising fashion relieving the strain on the British capital market.[183] As most trade was financed through London a rise in bank rate reduced the financial pressure on London by reducing the level of acceptances below those maturing, reduced the number of finance and trade bills and capital issues, and attracted short term funds to London. In the post-war system with 2½ centres funds could flow from one centre to another so one no longer had a closed system and a rise in bank rate could trigger a loss of confidence in a currency (Nurkse, 1944).[184] According to this argument the existence of several international vehicle currencies meant that international capital movements ("hot money" as it was then called) would no longer act in a "stabilising" fashion,- though as we have seen[185] this interpretation has its many critics and it has also been argued that what might have appeared stabilising to the UK (centre) was not so in the periphery.[186]

Furthermore, the level of the Bank of England's gold reserve, recommended in the Cunliffe committee report, was obviously too exiguous to fight off a major exchange crisis. It had been set at £150 millions sterling (equivalent to 18.75bn. French francs, the Bank of France considered its minimum gold reserve -"war chest"- to be 50bn. francs!). The Cunliffe committee had arrived at this sum by adding the pre-war Bank of England's reserves of £38.5 millions sterling to the pre-war level of gold in circulation, estimated at £123 millions sterling. In the belief that a central reserve fund could economise on the use of gold a figure of £150 millions sterling was set as a minimum reserve ratio. This illustrates the failure on the part of the British to comprehend the extent to which the financial balance of power had been altered by the conflict,- the UK was no longer so financially pre-eminent and

[182] see chapter two of this thesis.

[183] see Hawtrey (1970) p.187.

[184] To compensate for a possible 10% devaluation with its attendant exchange losses overnight interest rates would have to be incredibly high, which would reduce the long term credibility of such a policy. Unless it be to stem speculation caused by temporary uncertainty, e.g., a political crisis. Events in the ERM from September 1992 very clearly illustrate this.

[185] see chapter two of this thesis.

[186] see Ford (1960).

had to compete with New York as a world financial centre, and later on with Paris as a sort of half centre. Moggridge (1972) and Eichengreen (Golden Fetters) have also highlighted the weak balance of payments position of the UK. Given these factors it is probably safe to say that the UK's gold reserves were inadequate.

British experts (in particular Strakosch; and Hawtrey)[187] objected to France's failure to adhere to this gold exchange standard and to the legislation of 1928, which resulted in Paris drawing gold from London and so destabilising the system. But from a French perspective one might ask, "why should France not adopt a gold bullion standard, a necessary prerequisite for establishing oneself as an international financial centre and capital market?"

One has to bear in mind that a lot of UK foreign lending was authorised or favoured (by Montagu Norman) if it were tied to the purchase of British exports and that financial hegemony was a useful if, perhaps, unquantifiable tool in one's foreign policy armoury, and in helping to build and consolidate colonial links. French policy-makers certainly thought of it in those terms.[188] This was certainly felt to be the case in Britain and this fact is specifically alluded to in Churchill's speech restoring the gold standard in 1925.[189] South Africa had previously announced that she would return to gold in July. Fear that the Empire might adopt a dollar exchange standard helped precipitate the return to gold.[190] The League of Nations Gold Delegation (1932) was to recommend gold reserves of up to a maximum of 25%. This recommendation was endorsed by the World Economic Conference (1933), an implicit criticism of French policy.

Another sore point in the policy dispute between Britain and France was the fact that deposits at the Bank of France, including Treasury deposits, had to be backed by gold.[191]

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[187] see chapter ten of this thesis.

[188] On French financial imperialism Chandler has this to say about Moreau (1958), "He was more than willing to use the financial power of the Bank to further National interests, both economic and political."p.365.

[189] For Churchill's speech see pp.80-85 in Sayers (1976), Appendixes.

[190] Pegging colonial currencies on those of the centre was to have drastic effects on both Dutch and French colonial territories as their currencies became gradually overvalued. Within the British Empire, as of 1932, Empire free trade and floating sterling helped insulate and integrate the Empire under Neville Chamberlain as Chancellor,- he was the son of Joseph Chamberlain who had long been an advocate of Empire Free Trade.

[191] see chapter ten of this thesis.

Eichengreen (1985) has pointed out, in a brilliant monograph which displays a real insight into constraints acting on French policy-making, that the only real policy that France could have adopted to offset the effects of its "deflationary policy", was for it to engage in open-market operations. Legislation to that effect was only passed in 1938 after a protracted debate in the press, academia and within government. Objections were raised that this would be the beginning of a "*monnaie dirigée*" and would be ineffective because of the low degree of credit as opposed to cash in the economy.[192] However, the Bank of France did have the faculty to manage the money market by selling the zero coupon Treasury bills held on its behalf by the *Caisse d'Amortissement* in refund of the defaulted pre-war and war time Russian loans and losses incurred on sterling balances in 1931.[193] Such a policy would have been perceived as a dangerous departure by the Bank of France from existing practice and might have fuelled inflationary expectations and set a most unwelcome precedent. It would also have forced France to import inflation. France argued that gold exporting countries should tighten domestic credit conditions. Given the precipitate collapse of the Wall street "bubble" they may well have had a point.[194]

Eichengreen concluded his study thus, "whether accusations of sterilization were justified is simply a question of whether it is appropriate to attach these terms to the French Parliament's refusal to pass legislation permitting open market operations."[195] The argument in support of open-market operations loses some of its persuasiveness if one considers that gold inflows were not solely in settlement of balances arising from changes

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[192] see Aftalion (1930); and documentary Appendix.

[193] see documentary Appendix.

[194] One can draw a telling parallel with the results of the 1987 Louvres accord which, due to the primacy it put on stable exchange rates, caused Japan to maintain its interest rates at too low a level fuelling a stock market and property boom (asset inflation), whilst allowing the US to live on borrowed time and money by means of very substantial capital imports. When the "adjustment" came, in October 1987, it proved quite spectacular. Both the present experience and that of the late 1920s demonstrate how ill-advised a policy is which gives over-riding primacy to a fixed exchange rate commitment and in which the onus of adjustment is often perversely asymmetric.

[195] Quoted from Eichengreen (1985) p.30. Hawtrey believed that the cause of the influx of gold lay in the need for the Bank to cover the note issue, as it could not use government securities to this effect and was precluded from undertaking open-market operations. Hawtrey (1933) is of the opinion that, "Here is the cause at any rate the principal cause, of the loss of gold suffered by the Bank of England in 1929." p.131.

Einzig (1931) similarly condemned France for its financial regime-switch, from a gold exchange to a gold bullion standard and its attendant de-stabilising effects.

in the current account, but were pure capital flows dictated by considerations of currency stability and could well have been reversed. The contrary view would hold, viz., that gold inflows reflected a real demand for additional cash balances, if one accepts the Hawtrey/McCloskey & Zecher thesis.[196]

DEPRESSION AND BREAKDOWN OF THE GOLD EXCHANGE STANDARD:

In 1929 the bubble burst on Wall Street. This immediately brought relief to sterling. Since 1928/29 New York had been drawing funds away from Paris, London and Berlin to speculate on the stock exchange. This had particularly serious consequences in Germany as a part of the funds so obtained had been recycled to honour her reparations obligations, and with the onset of the depression unemployment began to rise and economic activity to slump. This led to a call for a final settlement of reparations,- the Dawes Plan had been provisional in the sense that no final figure had been set for reparation payments.

An international conference was convened at the Hague under the chairmanship of Owen D. Young who had been Dawes' assistant in the Dawes Committee (two meetings had to be held before an agreement could be reached). The Young Plan provided for the (gradual) commercialisation of reparation payments, something that the Germans had opposed since the Dawes Plan as it would prove much harder thereafter to reschedule, reduce the service payments on the debt and/or default. It was a policy which the French had pushed for since the London meeting of Herriot and MacDonald in 1924. It would seem that Germany had accepted this as a *quid pro quo* for the dismantling of Allied Controls and the (early) evacuation of the Rhineland. It has been suggested that Poincaré accepted the establishment of the committee - as it would produce a definite payment schedule - thus easing the ratification of the war debt settlements.

The whole plan was premised on a growth of world trade so that payments would gradually become less onerous for Germany. However, Germany was now responsible for the transfer,- a role which had previously devolved upon the Agent General for Reparations. The sum was divided into two parts, 1) a non-deferrable schedule, and 2) a deferrable (for 2 years) schedule. The plan implied a reduction in the sum due.

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[196] see chapter two of this thesis.

Schacht argued (1955), in his memoirs, that the French had attempted to put pressure on the mark during the negotiations by withdrawing balances. According to Schacht he informed Parker Gilbert, the head of the Transfer Committee, pointing out that if France persisted a weakening of the mark would only support the German thesis that they could not pay. Apparently the French desisted.[197]

However, these arrangements were to be short-lived and the banking crisis which spread over Europe during the summer of 1931 was to bring about the downfall of the gold standard. The French arguably contributed to the collapse of the Austrian banking system and that of Germany by their delaying tactics, due to political considerations, on two critical occasions. Earlier in the summer of 1931 Germany and Austria had declared their intention to form a customs union which the French interpreted as the first step towards political union, an *Anschluss*. This policy had been declared in breach of the Versailles Treaty and the Austrian League loan by the International Court of Justice at the Hague.[198]

When the Kreditanstalt failed France withheld its assistance until Austria had backed off from its proposed customs union.[199] However, by then the Austrian government had fallen. Although Norman had stepped-in in June with loans extended on a weekly basis the banking panic and crisis spread to Germany with which Austria had close economic and banking ties. Following the collapse of the Danatbank, the whole German banking system and stock exchange was closed.[200]

This had been preceded a few weeks before by Hoover's proposed one year moratorium on all inter-governmental debts and reparations,- the first tacit official recognition by the US of a link between reparations and war debts. Some have argued that Hoover acted in order to prevent a two year moratorium which was permitted under the deferrable schedule of payments of the Young Plan. However, France delayed at this critical

[197] Quoting Hawtrey (1933) p.144, "In the spring of 1929, when the Young Committee on Reparations was sitting, Germany suffered a loss of $230 millions, which was said at the time to be due to the withdrawal of French and Belgian balances."

[198] This point might warrant further investigation as it underlines the political nature of such loans, and therefore supports Moreau's thesis. An analysis of conditions attached to this loan and others, such as that to Hungary, would be of use in substantiating their political nature.

[199] see Clarke (1967).

[200] Norman had also given assistance to the Reichsbank by making an overnight deposit of £5 millions sterling to cover the deficiency in its reserve requirements.

juncture agreement for two weeks insisting on payment of the non-deferrable schedule of reparations which would be held by the B.I.S. and used to give credit to Central Europe.[201] The Hoover moratorium came into effect on 1st July 1931 and was to last until 30th June 1932. It was followed by a six month Standstill (Wiggin/Layton committee recommendation) on all private debts. This was periodically renewed.

In the summer of 1931 speculative pressure began to spread to sterling. The Macmillan Committee Report had just been published, and it gave what seemed to be worrisome estimates of the amount of short-term balances now blocked in Central Europe,- these figures are considered to be underestimates by Moggridge (1972). The evidence given before the Macmillan committee also sheds a great deal of light on Montagu Norman's and other protagonists' beliefs regarding economic policy. This was followed, by the publication of the May Committee Report which forecast a budget deficit of £120 millions sterling for 1932/3 and recommended reducing expenditure by £96.5 millions sterling and raising taxes by £23.5 millions sterling. The perversity of orthodox policy is readily apparent if one considers that in 1931 UK GDP declined by 5%![202] But, the most controversial aspect of the report was the recommendation to cut unemployment benefits by 20%![203] Opposition to this measure broke the Labour Government. In fact Ramsay MacDonald found himself in a minority in Cabinet, though he retained the support of his Chancellor of the Exchequer, Sir Philip Snowden. In the circumstances Ramsay Macdonald resigned, but rather to his surprise was asked by the King to form a National Government.

Foreign loans to support sterling were not forthcoming till the government could produce a plan to balance its budget. Hence, the cry raised at the time of a "bankers'

[201] Néré (1975) p.103.

[202] see statistical Appendix.

[203] At the time unemployment benefits were considered to contribute to the rate of unemployment (see Rueff, 1931), the whole debate has been revived in recent years. Rueff argued that the depression reduced pay in work whilst raising the real rate of unemployment benefit, this reduced the incentive to find work. An extreme supply-sider might quip that the 14.8% of the British labour force who were said to be unemployed were so voluntarily or inter-temporally trading leisure for work! Unfortunately the contingent state of world affairs dictated that in the early 1940s their efforts would be directed towards war, rather than satisfying the deferred demand for leisure! Unemployment data can be found in, A.Maddison (1982).

ramp"[204] similar to those voiced against the "*mur d'argent*" and the "*deux cents familles*" by the left in France. The Invergordon mutiny over naval pay cuts further shook public opinion. Earlier in the summer, on 25th July, a credit for £25 millions sterling had been arranged with the Bank of France and on the 30th a credit for £25 millions sterling from the Federal Reserve Bank of New York to give support to sterling on the spot and forward markets. Confidence had been weakened by the rise in the fiduciary issue from £14 to £15 millions sterling which would free an additional £1 million sterling worth of gold, or $4.86 million.

Ramsay MacDonald returned as Prime Minister in a National government with the arch-orthodox Snowden as his Chancellor of the Exchequer. Unemployment benefits were reduced by 10% and taxes raised. Following these austerity measures the National government on 29th August received credits from New York and Paris worth $200 millions each. But it was too late and on Sept. 21st the gold standard had to be suspended and bank rate raised to 6.5%,[205] presumably to avoid imported inflationary pressure and compensatory wage demands. Such a measure also indicated that the government meant business and would tend to attenuate any flight from the currency.[206] This should be compared to the measures which accompanied the Blum devaluation which increased government expenditure, despite a ballooning deficit and which was followed by a steep reduction in interest rates.

France's response was to introduce compensatory duties on British goods and those of countries which devalued alongside sterling. Most observers have concluded[207] that France had been helpful during the sterling crisis. The Bank of France certainly made

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[204] Echoes of this were heard in the sixties with disparaging remarks about the "gnomes of Zurich", particularly from within the British Labour party, and following the UK borrowing from the IMF in 1976 which was accompanied by demands for reductions in public expenditure and controls over the growth of the money supply.

[205] Moggridge (1972) concludes on the question of the 1931 British financial crisis that, "By late August it was probably too late to save sterling, even if it had been possible through very drastic measures previously, for even central banks were beginning to fear for the future and ask for gold guarantees for their sterling balances or withdraw them." p.196.

[206] Hayek (1932) argued that the UK should have raised bank rate up to 6.5% or higher before suspending the gold standard and that failure to do so only proved its unwillingness to remain on gold. However, this is clearly preposterous as MacDonald went as far as to break the Labour government to remain on gold.

[207] see Kindleberger (1973).

exchange losses which were subsequently refunded by the state. These losses amounted to 2.3 billion francs on sterling holdings.[208] Following devaluation and the losses thereby incurred Eichengreen states that Laval travelled to the US in October to discuss currency issues. Apparently the Bank of France wanted to withdraw balances held with the Federal Reserve Bank of New York. In exchange for maintaining these deposits Laval apparently extracted a pledge that the US would not again take unilateral action with regard to war debts and reparations.[209] Eichengreen points out that it was in France's interest as the dollar was coming under pressure as a result of gold losses, French withdrawals would have made the matter worse, and had the dollar been devalued the next candidate for speculative attack would have been the French franc.

Following devaluation the UK set up an exchange equalisation account in 1932 with a fund of £150 millions sterling,- in this regard the experience of managing sterling during the summer of 1931 apparently proved invaluable to the Bank of England. The E.E.A.'s operations were to be secret and Howson (1980) concludes that it helped hold down the value of sterling.[210] But most significantly, although managed by the Bank of England, the E.E.A. operated on behalf of the Treasury. Devaluation followed by a managed currency marked the collapse of Montagu Norman's dream of reconstructing an international gold standard operated by independent central banks.[211] The Exchange Equalisation Account would become a widely imitated and essential tool in the monetary and economic armoury of nations as the international financial regime gradually broke-up in the 1930s.

Managed money allowed the Treasury to reduce servicing costs on the national debt

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[208] Wolfe (1951) p.99.

[209] see Golden Fetters, p.294, footnotes 7 & 8.

[210] see Howson (1980).

[211] Norman realized this. Boyle (1967) quotes Montagu Norman on this issue, "I am proud to think that I am a Central Banker (he said to a gathering of Commonwealth Bank Governors in 1937) but I would also ask you to remember that I am an instrument of the Treasury... When the gold standard was abandoned, there took place an immediate redistribution of authority and responsibility which deprived the Bank of some of its essential functions. Foreign exchange became a Treasury matter, and perhaps it still remains to be seen what other responsibilities pass with it from Threadneedle Street to Whitehall." p.287. In the present-day context (1992) one might similarly muse over what other attributes of our economic and political sovereignty we will lose as a consequence of joining the ERM and agreeing to the principle of EMU?

The UK has already imported (1992) the worst recession since the 1930s as a result of its fixed exchange rate commitment which imposes an overly tight monetary policy which is wholly inappropriate to the needs of the domestic economy (see A.Walters).

with the introduction of a policy of "cheap money." The 5% War loan was converted to 3.5%, and from 1933-8 a 2% bank rate was maintained. These savings reduced the burden on the budget, "This successful operation contributed to the fall in debt service as a percentage of national income from 8.3 per cent in 1932 to 4.6 per cent in 1935."[212] Intrinsic to the policy of cheap money were the balanced budgets practised through 1932-35, under Neville Chamberlain's stewardship of the Exchequer. These helped maintain confidence.[213]

Snowden had remained Chancellor till the October 1931 elections after which he returned as Lord Privy Seal. He resigned in September 1932 along with many liberals in government in protest at the Imperial tariff preference policy pursued by Stanley Baldwin who as Lord President of the Council was *de facto* prime minister. Baldwin became prime minister in June 1935 when Ramsay Macdonald retired. In May 1937 Baldwin was succeeded as prime minister by Neville Chamberlain.

The British economy began to recover behind the system of Empire preferences, established at the Ottawa 1932 Conference. Increasingly a closed Empire financial and trading system was built around sterling, behind protective tariff walls. Loans raised in London were increasingly for the Empire. These were controlled by the Capital Issues Committee, headed by Montagu Norman - he had controlled access to the British capital market before the return to gold in 1925. The advantage of the closed economic system, centred around sterling, is that it brought to an end deflationary forces which were transmitted across the exchanges.[214] The effects of these forces on budget revenue and the prevailing rule of fiscal orthodoxy had forced government to adopt perverse deflationary macro-economic policies (q.v., French experience throughout the 1930s). By adopting what amounted to a "managed float" the UK authorities were able to maintain a low bank rate, at 2% throughout this period. It allowed concentration on domestic factors and the adoption of policies more in line with the domestic economic conditions. It is this, rather than a revival of trade within the protected Empire which was of the most significance in furthering economic recovery. The balanced budgets of the period were the necessary psychological

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[212] From Cairncross & Eichengreen (1983) p.101.

[213] see Middleton (1985).

[214] see also Eichengreen Golden Fetters.

ingredient in reinforcing confidence and allowing a successful debt conversion operation and in keeping interest rates low.

This "closed" system built around one centre would obviously prove less brittle than one based on 2½ clearing centres. If confidence revived so would international liquidity within such a system.

France's experience was not to prove so felicitous, though the depression was not to hit her till the end of 1930. Eichengreen (Golden Fetters) argues that the "gold avalanche" helps explain the late downturn in economic activity in France as it allowed the Bank to pursue a less restrictive policy for longer.

Over the period 1930-35 France registered a cumulative decline in GDP of 9.1%; the US a decline of 9.4% but the UK registered a cumulative GDP growth rate of 8.9%. As a measure of the deflationary shock imposed on France by the high exchange and real rates of interest, and perverse policy stance one should record that the cumulative price decline in France was 28.8%; 18% in the US and only 8.9% in the UK. We have already noted Lutfalla & Patat's (1986) M2 estimates. Their data also register a fall in the velocity of circulation. It declines from a peak in 1926 to a trough in 1934, picking up again in 1937. This behaviour in the mid-1930s is consistent with a deflationary (the real yield on cash balances being significantly positive) and uncertain environment.

However, Lutfalla & Patat's conclusion is somewhat at odds with their empirical analysis. Whilst they recognise that easier monetary conditions and particularly lower real interest rates and less of an obsession with a fixed exchange would have mitigated the worst effects of the French depression, they then go on to suggest that in any case the high exchange rate was not so significant in a country in which imports as a percentage of national income had dropped from 17% in 1913 to 8.5% in 1935. However, the high exchange rate led to imported deflationary pressure and imposed a perverse deflationary macro-economic policy the ensuing fall in the price level yielded the high real interest rates which Lutfalla & Patat recognise exacerbated the severity of the downturn in economic activity.[215] This can

[215] Quoting Lutfalla & Patat (1986), *"On peut admettre qu'une action monétaire plus souple durant les années 1930, avec en particulier des taux d'intérêt moins aggressivement positifs et une religion moins marquée pour le taux de change, aurait évité à la France sa pire période de décadence économique. Cette orientation n'était pas très dangereuse dans un pays qui s'était presque complètement refermé sur l'extérieur (le ratio importation/Revenu National était tombé à 8.5% en 1935 contre 17% en 1913)."* from, Histoire Monétaire de la France au XX siècle. However, if one takes A.Maddison's (1991) figures for the volume of exports one finds that in 1935 French exports are at 82 (1913:100); UK exports at 60; and US exports at 97.7. This

explain the fall in imports. One should add that Lutfalla & Patat's figures for imports as a percentage of national income are expressed in value terms, as a result the high franc exchange rate and weak commodity prices would tend to depress the figure. A more meaningful measure would be the aggregate traded goods' sector by volume which would measure the degree of open-ness of the economy. According to our implicit model the French economy suffered from the deflationary effects of international price arbitrage, and high real domestic interest rates, which was compounded by perverse macro-economic policies which put the economy on a disequilibrium path of cumulative deflationary decline, as a result of the *de facto* fixed exchange rate regime.[216]

One should point out that though France's experience of economic depression proved more protracted than the UK's, the French economy did not suffer from such high levels of unemployment as in the UK and US. The reasons usually adduced for this are, 1) a larger agricultural sector which might tend to disguise unemployment; 2) the fact that the population flow from the land to the city slowed;[217] 3) the fall of the number and return of immigrants. Figures from A.Maddison for France in the inter-war years are incomplete, however the highest level recorded amongst figures available register a rate of 4.5% in 1936.[218] For illustrative purposes one should record that in the same year unemployment in the UK stood at 9.2% down from a 1930s peak of 15.3% in 1932; in the US the rate in 1936 was 9.8%, off a peak of 22.3%! in 1932.

In 1929/30 French budgets were back in deficit as fiscal revenues fell with the depression and expenditures rose. The brunt of fiscal adjustment were borne by reductions in expenditure,- as in the UK prior to devaluation. In 1932 the Tardieu government tried to manipulate the budget in order to present it in balance. The budgetary year was pushed forward to April. The effect of synchronising the date for estimating revenues and expenditures resulted in 12 months revenues covering 9 months expenditures. This measure was also introduced so that it would prove easier to pass the budget before the beginning of the calendar year thereby increasing confidence. Commentators who have been critical of

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suggests that France's experience was not unexceptional.

[216] see also Eichengreen Golden Fetters.

[217] see Sauvy (1984).

[218] source: A.Maddison (1982) p.206.

the measure as purely opportunistic have not considered the problem of the Christmas recess. The beginning of the financial year was set at the 1st of April, as in the UK. Tardieu was an admirer of the British political system which produced more stable government.[219] It is perhaps no accident that he should have thought of this reform. However, the measure was discarded the following year.

The year 1932 witnessed the final liquidation of reparations and war debts. At the Lausanne Conference it was agreed to consolidate reparations payments into 3bn. marks of bonds which were deposited at the B.I.S.. They were never issued nor honoured. This arrangement had been made conditional upon the creditors receiving a favourable settlement from their own creditor, the US. This was not forthcoming, but in the event it made little difference. France defaulted on its war debts to the US in 1932,- Herriot, then Prime Minister, had proposed making the payment, but Parliament refused and his government fell. As Mouré points out Herriot could not secure socialist support for his deflationary policies, particularly reductions in administrative expenditure and decided to fall on the war debts issue.[220] Great Britain was to default soon after,- the only country to fully honour its war debts was Finland!

The US which was in the throes of depression resented France's attitude, given the size of its gold reserves. However, France, certainly since Governor Pallain's day had treated its gold reserve as a strategic stockpile and not "truly" as a reserve to be used indiscriminately. Did this incident in anyway affect the US's unilateral action before and during the World Economic Conference?[221] France considered its strategic stockpile to be 50bn. francs. In view of the subsequent US policy dictated by the Johnson Act of 1934 which stipulated that supplies be delivered on a cash-and-carry basis, this policy was not altogether unwise.

By 1932 France was deep in depression. The two troughs of the depression being spring 1932 and April 1935.[222]

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[219] see chapter one and the debate over constitutional reform.

[220] Mouré (1991) p.165.

[221] Clavin (1991) has argued that the UK's reluctance to honour its war debt ahead of the World Economic Conference, as well as the system of Empire Preference, did spoil anglo-american relations.

[222] see Braudel & Labrousse (1980).

The World Economic Conference held in London in 1933 is crucial to our study as it led to the formal breakdown of the gold exchange standard and the creation of the Gold Bloc. The conference was convened to try and rebuild the international financial system. However, in 1932 ahead of the conference the UK set up its Empire preference system and in 1933 as MacDonald sailed to meet Roosevelt the US devalued,- not because its price level was too high as had been the case in the UK, but to raise it (a paradox alluded to by Hodson). Both events augured ill for an internationally brokered solution to the depression.

A tariff truce was adhered to during the London conference, though France did not formally undertake to abide by it. Given the US's refusal to enter into a fixed exchange rate commitment it is understandable that the French authorities should want to retain tariff autonomy. The end result of the conference was that the US refused to give priority to stabilizing exchange rates and preferred to allow its exchange rate to float whilst seeking/and as a means to reflate its domestic price level. A strategy which Keynes dubbed "magnificently right." However, it scuppered the chances of an international currency agreement which might have paved the way for trade liberalisation on the part of France in return for some commitment to fixed exchange parities.[223] However, domestic pressure in all three countries pulled in different ways, with a reflationary lobby in the US; a distaste for gold and a fixed exchange rate in the UK; and in France, domestic pressure for protection, particularly in the agricultural field and a pronounced reluctance to agree to any currency regime which did not incorporate some reference to a return to gold.[224] However, as Eichengreen cogently points out, and Keynes realised, the breakdown of any pretence at international monetary policy co-operation was in fact beneficial to the US and UK as it allowed them to pursue economic and monetary policies consonant with the demands of their respective domestic economies.[225]

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[223] see Golden Fetters, p.318.

[224] see Golden Fetters.

[225] Similarly the suspension of the pound sterling from the European exchange rate mechanism on 16/9/92 offers the prospect for economic recovery in the UK for the first time since entry in October 1990. It is chastening to think that the Treasury was to embark on a tight expenditure round, whilst originally intent on maintaining its fixed parity against the D-mark. Clearly the lessons of history have to be relearnt by every passing generation. Libraries, the repositories of ancient wisdoms and the essential tool of inter-temporal discourse, are too often ignored for every passing fad.

One should however note one of the distinguishing features of the present (September 1992) difficulties within the ERM and those besetting the Gold Bloc. In the case of the ERM the disregard on the part of the

Only the Gold Bloc countries would remain wedded to the liberal economic model,- in theory if not in practice, q.v., French protectionism,- whilst closing their eyes to the fact that it had rested on very specific factors, most significant amongst which were credibility; relative open-ness in trade relations; co-operation; and a lack of domestic politicisation of the economic debate. One should add that the behaviour of the Gold Bloc states (and the UK) would be largely informed by past experience. In the case of the Netherlands and Switzerland both of which were members of the Gold Bloc neither had been a belligerent state, nor had they devalued against their pre-war gold parities, and they enjoyed substantial gold reserves. In this context one should note that it was considered that the UK had been pushed off gold, whilst the US's unilateral and deliberate action was considered in many circles as irresponsible and not to be replicated. The other members of the Gold Bloc, viz., France, Belgium, and Italy had suffered years of financial, fiscal, and foreign exchange instability after the war and considered the gold standard as a fixed anchor of stability. One should add that in Italy devaluation would have been considered a serious loss of face for Mussolini who at Pesaro, in 1927, had pledged that the lira would never be devalued.

CONCLUSION:

To characterize, in summary fashion, both governments' macro-economic stance one might say, that British budgetary policy was far tighter than the French whose budgets were in deficit from 1919 to 38 except for the period 1926-29, and that monetary policy was far more accommodating in France than in the UK throughout the period.[226]

German Federal government for fiscal orthodoxy (and unwillingness on the part of its partners to countenance a revaluation of the D-mark) forced up ERM interest rates in a form of beggar-thy-Euro-neighbour policy an illustration of the need for not only monetary co-operation (*vide* Eichengreen), but also fiscal co-ordination (given the fixed exchange postulate, though even in a floating regime lack of fiscal coordination can have very significant economic effects through appreciation of the real exchange rate) now that financial orthodoxy no longer binds governments. Intervention to support the weaker currencies in the second week of September 1992 failed because credibility was eroded by the economic and therefore political costs which defence of the weaker currencies imposed, along with their somewhat "discreditable" past. In the case of the Gold Bloc the original deflationary shock was external, viz., depression transmitted across the exchanges from the US. This was perversely compounded by a domestically induced shock to demand as fiscal policy proved un-accommodating,- though this is somewhat masked by the substantial deficits incurred in France during the depths of the depression, but this was only because national income fell faster than government could reduce expenditure.

[226] On the UK fiscal stance see Middleton (1985) who points out that the greater the built-in stabilizers the more "perverse" budgetary policy need be in a depression given a balanced budget rule.

What general conclusions does this comparative study of French and British inter-war experience suggest? I think that one of the most important lessons is the need to understand the institutional, political and historical constraints within which policy is formulated. In this respect the greater instability which characterised the French polity is significant. The unresolved fiscal debate is partly a measures of this. In France in the 1920s this *impasse* was resolved through recourse to inflationary government finance by way of recurrent advances from the Bank of France to the government, both direct and indirect, accompanied by the periodic raising of the "*double plafond*" till 1926. The existence of the "*double plafond*" contributed to inflationary expectations.

In the 1930s the institutional deadlock and fiscal crisis was resolved through the abdication of parliamentary sovereignty to governments which were given temporary power to reduce expenditure by decree.[227]

In the UK there was far less political instability, and the legacy of war finance and the floating debt was less acute. France's war effort had, to a far greater extent than Britain's, been financed by short-term borrowing and the creation of money which effectively ruled out a return to the pre-war parity. The UK with a less onerous post-war burden and the perceived need to maintain a unified Imperial system was obsessed with the need to return to pre-war parity. This was in part due to the belief that Britain's pre-war prosperity was attributable to free trade and the gold standard which established sterling as the world's vehicle currency in which trade and finance was transacted.[228] According to this view, London had acted as the hub of the world's commercial system functioning as its clearing centre, from which capital flowed out providing it with the necessary invisible earnings to cover its traditional deficit on merchandise account. However, policy-makers failed to recognise the special historical circumstances of the pre-war system.[229]

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[227] see Gignoux (1943), L'économie Francaise entre les deux guerres 1919-39, p.223. Gignoux points out that the Chamber which had delegated/abandoned its authority to Laval in 1935 did not disdain condemning the ensuing unpopular measures.

[228] The textbook gold standard was premised on free trade, both are synonymous concepts from this perspective. An independent, impersonal and fixed monetary standard such as the gold standard which would act as a permanent foundation for free contract and exchange based on a concept of personal property relations is consonant with the 19th century liberal philosophical ideals which are now sometimes characterised as "negative" freedoms, though this is not how they were perceived at the time.

[229] see chapter two of this thesis.

We again find the legacy of history bearing heavily on policy regarding France's post-war reconstruction finance which, for political reasons and the nature of the parliamentary system, had to be financed by borrowing on the assumption that Germany's reparation payments would service the debt. One could regard this as beneficial to the economy as it no doubt speeded-up the reconstruction effort. But, it also contributed to the gradual collapse of the franc as did the concomitant policy of trying to enforce payment of this debt, viz., the Ruhr occupation.

The immediate post-war French experience is characterized by inflationary government expenditure. From 1926 to 29/30 France's finances were "*assainies*", but with the advent of depression budgets went again into deficit and governments had resort to both direct and indirect advances from the Bank. During the depression recourse was had to cuts in expenditure (this was the case in the UK in 1931), and other deflationary measures by decree. Devaluation was rejected, in part, because of its association with inflation[230] and the belief that the *rentiers* had already been sufficiently penalised by the Poincaré "stabilisation". From 1930-on governments increasingly nominated their own appointees as Governors of the Bank of France.

In Britain, the Bank of England was much more independent of the Treasury. Montagu Norman held the Governorship for an unprecedented period running from 1920-44, imparting a greater degree of stability to its management. This precluded government from monetising deficits and helps explain Britain's more "successful" inter-war monetary history. Governors of the Bank of France, since Napoleon's reform of the bank's statutes, always remained beholden to the government, though this did depend on personalities and circumstance.[231]

Following devaluation in 1931 the UK followed a more autarkic policy centred on the system of Empire Preferences. After the failure of the London World Economic conference in 1933 the Gold Bloc was formed. This over-valued currency bloc resulted in deflation and protracted depression. Britain during the period 1932-5 followed a policy of balanced budgets, cheap money and a managed, undervalued, currency, rejecting the option of

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[230] see chapter seven of this thesis.

[231] Though this sort of distinction can be over-played, generally societies get the monetary policies they deserve.

resorting to large scale deficit-financed public works.

Various reasons have been adduced for this, viz., the "Treasury view," that is that public works schemes would crowd-out private investment, given the posited existence of a fixed pool of savings, and that deficit financing of such schemes via the printing press, would be inflationary.[232] Hopkins, a senior Treasury-man, believed that non self-liquidating expenditures should only be financed out of current reserves, and that only self-liquidating capital expenditures be financed by borrowing. A policy of loan financed public works would drive up interest rates and so conflict with cheap money.[233] In this regard[234] it would seem that Neville Chamberlain's policy of maintaining balanced budgets from 1932 to 1935 was necessary to maintain confidence and cheap money,- thus reducing the government's debt service burden and allowing tax cuts. But most importantly this policy mix arrested the perverse deflationary macro-economic stance, which had been dictated by the fixed exchange rate commitment imposed by the gold standard.

The fixed exchange rate commitment in the UK had been largely responsible for a decade or so of deflation and unemployment. Nominal prices proved inflexible (as Keynes had forecast) and the resultant was that UK economic performance in the 1920s was considerably below the rate recorded in France and the US. Cumulative GDP growth over the period 1919-1929 was 78.5% in France; 40.76% in the US; and 10.9% in the UK.[235] In the 1930s the position was reversed with France now committed to an increasingly over-valued fixed exchange rate registering a cumulative growth rate of 0.3% during the period 1931 to 1936, whilst the UK registered a rate of 20%.[236]

There was a very real risk that the UK economy in the early 1990s would find itself in a similar situation once a fixed exchange rate commitment had become an economic policy target, some might argue the only one.

This chapter has attempted to underline the need to take into consideration, in

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[232] see chapter five of this thesis.

[233] In this case reference is being made to a loan financed public works programme which would not involve the creation of additional money.

[234] see Middleton (1985).

[235] source: A.Maddison (1991).

[236] Figures calculated from A.Maddison (1991), Table A.7, pp.212-215.

particular whilst assessing the conduct of French inter-war monetary policy, the historical, institutional, political, diplomatic and expectational (in terms of the expected rules of conduct of government and finance) nexus from within which monetary policy must issue. It is, therefore, in a sense, a call to open up the *ceteris paribus* clause and to examine policy from within the operational constraints.

CHAPTER 4

BUDGET DEFICITS AND FINANCIAL INSTABILITY

This chapter aims to demonstrate that the proximate source of financial instability during the period 1920-26 resided in war finance and post-war reconstruction expenditure. This led to large budget deficits and an accumulation of short-term unfunded floating debt. The unconsolidated debt with maturities typically of one month, three months, six months and one year meant that the government's treasury position was constantly at the mercy of "sentiment."[1] Should a crisis of confidence develop, as it did from the Ruhr occupation to the Poincaré stabilisation, inability to renew debt maturing would leave government finances in an impossible situation. The only recourse, as proved to be the case in 1925-26, was to the printing press. During a period of crisis such desperate expedients as Caillaux's *emprunt à garantie de change* issued in July 1925 would prove a failure, illustrating the near irrational depths to which sentiment could sink. Blum's exchange guarantee gilt issue in 1937 was to fail for similar reasons. Caillaux's loan would actually raise the debt service cost as it was principally subscribed through the surrender of existing debt which did not enjoy an exchange guarantee.

It was only after the 1926 stabilisation and the establishment of the *Caisse de Gestion des Bons de la Défense Nationale et d'Amortissement de la Dette Publique* that the government was able to retire a substantial proportion of the floating debt. From 1926-29 a period of balanced budgets saw a return to confidence, and though recession had already settled-in in 1932 the conversion operations of the *rentes* carried-out in that year (the last of the so-called "gold avalanche" years) was a success, aided no doubt by the resilience of the franc following sterling's devaluation,- this probably ensured a better out-turn for the conversion operation.

The period 1931-36 is marked by attempts to resolve the budget deficit. Despite desperate attempts to reduce expenditure, falling revenue due to the cyclical downturn in budgetary revenue made the exercise self-defeating. In fact it was during the period of

[1] Dulles (1929), p.335; and Pirou (1936).

Laval's deflation *à outrance* that budgetary expenditure as a proportion of national income was to reach its inter-war all time high, excluding 1938.[2] Reducing expenditure proved difficult as such a substantial proportion was accounted for by the burden of the past, with some 40% earmarked for debt redemption and war pensions.

From 1935 we see a renewed process of indirect advances to government. The Popular Front government sought to take the courageous step of regularising these advances with the Bank of France and demanded new advances, effectively increasing the note circulation *pro tanto*. This combined with the government's economic policy contributed to undermining the franc. Devaluation followed in September 1936. From then-on the aggregate budget deficit would be financed virtually in its entirety through increases in the note circulation. The main source of the deficit were the renewed extra-ordinary budgets which were used to finance re-armament, nominally off-budget. The expenditure was largely unfunded and financed by printing money.

If one looks at ordinary budgetary expenditure in 1913 we see that the aggregate figure was FRF 5,066.9m. of which FRF 1,286.1m. was devoted to annual debt service charges, i.e., 25% of expenditure was devoted to debt service.[3] Total budget revenue as a proportion of national income was 12% in 1913;[4] 17% in 1920; and reached an inter-war peak at 23% in 1923 and then hovered between 17% to 19%; and a low of 15% in 1926. By 1919 ordinary budgetary expenditure had grown to FRF 11,028.6m. whilst the extra-ordinary budget deficit amounted to FRF 28,941.5m. Aggregate expenditure totalled FRF 39,970m. of which FRF 7,008.5m. was devoted to debt service. The debt service ratio (as a proportion of budgetary outlays) had actually fallen, but only because total expenditure had increased so rapidly and had been financed through note creation and the issue of Treasury bills rather than borrowing. However, the 1919 figure for aggregate budgetary expenditure is grossly distorted by the very high level of military expenditure in that year (FRF 16,705m.) and reconstruction expenditure (FRF 8,401m.). These three items, viz., debt service, military expenditure and reconstruction expenditure, accounted for 80% of total

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[2] see Sauvy (1984).

[3] Source: Statistiques (1963); m. is short-hand for millions of francs throughout this chapter and bn. for *milliards*.

[4] Sauvy (1984) p.101.

budgetary expenditure. The large budget deficit of fiscal 1919, was principally carried under the extra-ordinary budget and was premised on German reparations payments,- this presaged difficulties to come. Sauvy (1984) gives a figure of FRF 26,688m. for the total budget deficit in fiscal 1919. This figure is marginally below that of the extra-ordinary budget. This points clearly to the sort of illusion upon which French post-war budgets were to be based.

After the cessation of hostilities the *Crédit National* was created in order to finance reconstruction. It was empowered to issue short-term bills (*bons*) which were re-discountable at the Bank of France and which acted as a constant monetary over-hang. It will later be argued that these were effectively quasi-money and that loss of confidence in government and failure to renew bills falling due was the cause of the protracted financial crisis from 1923 to 1926.

In order for the government's treasury position to have been sound it would have had to match assets and liabilities in order that the flow of reparations payments would match the annual costs of financing the domestic debt which was secured upon it. This was not the case, and the sharp growth in short-term floating debt was to be the cause of eventual financial crisis. The floating debt largely took the form of *bons de la défense nationale* which first appeared at the outset of hostilities.[5] These largely replaced Treasury bills. The *bons*, unlike Treasury bills were offered at a discount, equivalent to the prevailing interest rate on the par value at issue. Interest was offered up-front as an additional incentive. *Bons* of one month, three month, six month and one year maturities were issued. On the longer-dated bills the discount up-front would lessen the potential risk of capital loss on the paper, if traded before maturity i.e., it became equivalent to a promissory note.

The Statistiques (1963) give the following figures for the total government debt outstanding at 31st December 1913, viz., FRF 33,637m. of which FRF 2,081m. consisted of floating debt, or 6.2%. By 31st December 1919 total outstanding debt had risen to FRF 217,848m. or over seven-fold, whilst short-term debt now accounted for 51% of total debt, or FRF 111,704m. The total floating debt since 1913 had risen over 53 fold! Whilst over

[5] "National Defence notes were accepted for discount, with the signature of the borrower, if they had not more than three months to run, while Treasury notes and obligations could be used as the basis of loans at the higher rate. After 1926, when the National Defence notes of short maturities were gradually refunded into two year notes, this type of rediscounting declined, since it was only as the notes approached maturity that they were acceptable to the Bank." Myers (1936) p.15.

the period under review consolidated debt had only risen from FRF 21,922m. to FRF 88,592m. Eichengreen points out that the level of debt in 1914 was already high, largely due to the reparations paid by France following the Franco-Prussian war.[6] The failure to consolidate the floating debt immediately after the end of hostilities, or to secure forced conversion meant that governments would be all too dependent upon shifts in public confidence in order to secure renewal of the short-term unfunded debt.

Another significant source of funds for government during the war were the periodic increases in advances from the Bank of France to the Treasury. These would be directly translated into increases in the note circulation. The government was empowered to raise the ceiling on advances and the note circulation by administrative decree during the war.

Haig (1929) gives the following figures for the note circulation of the Bank of France: in January 1914 it stood at FRF 5,894m. with a ceiling of FRF 6.8bn. to the note circulation set on December 29th 1911 (Haig). On August 15th 1914 the legal limit to the note circulation was raised to FRF 12bn. In July 1914 the note issue stood at FRF 5,912 million and by December 1914 the note circulation had risen to FRF 10,043 million.[7] The legal limit to the note circulation was raised periodically throughout the conflict to be fixed at FRF 36bn. on February 25th 1919, the actual circulation in January 1919 stood at FRF 31,794 million.[8] From July 1914 to January 1919 it had risen 540%.

The limit on advances from the Bank of France to the government were periodically raised during the war. These stood at FRF 2.9bn. on August 5th, raised to FRF 6bn. in December 1914 and thereafter periodically raised to reach a peak of FRF 27bn. in July 1919,- it would rise beyond this during the financial crisis year of 1925. The FRF 24.1bn. increase in the limit on advances was virtually equivalent to the increase in the legal limit on the note circulation which in May 1918 was FRF 23.2 bn.[9] Under the provisions of the François-Marsal convention, which aimed at gradual disinflation, the legal ceiling on advances was gradually reduced to reach an official minimum of FRF 22bn. on January 1st 1925. What these figures illustrate clearly is the extent of potential short-term liabilities,

[6] see <u>Golden Fetters</u>, p.78.

[7] Rogers (1929) p.62.

[8] see Rogers (1929).

[9] see: Decree of 3rd. May, Haig (1929), p.210.

viz., bank-notes[10] and floating debt which had resulted from war expenditure.

The substantial floating debt was to be a constant worry to all governments until 1926 and the five-fold increase in the money supply was to be translated in a rapid depreciation of the currency on the exchanges, which began as soon as exchange support operations were suspended in March 1919. Eichengreen estimates that at the end of the war the franc was overvalued by as much as 35% against the US dollar and 10% against sterling.[11]

Sauvy (1984) gives the following figures for the currency's depreciation against the dollar. Figures used are monthly average rates.[12] The par rate of exchange on a gold basis would have been 5.18. In January 1919 the FRF was at 5.45 and at 25.97 against sterling (the par rate being FRF 25.22). By December 1919 the FRF was at 10.87 against the dollar, or at some 47.7% of its pre-war gold parity, whilst against sterling it stood at 41.81, or at some 60% of its pre-war value. This undoubtedly reflected the sounder financial position of the dollar at the end of the war. However, though the FRF's discount against its pre-war value was steep the process of depreciation was relatively gradual.

The failed Ruhr invasion and the financial incompetence of the Cartel was to issue in an accelerated financial and exchange crisis, both in 1924 and 1925-26. In these circumstances even the most desperate expedient, i.e., Caillaux's *emprunt à garantie de change* (gilt issue with exchange guarantee) failed. Confidence would only be regained with the formation of the Poincaré government which marked a radical change in policy orientation, and a determined effort to tackle the budgetary problem, the floating debt and restore confidence.

Though the year 1919 was to register the largest nominal deficit till 1938, the cumulative deficit over a period to 1926 meant that public debt remained at a very significant level. The Statistiques (1963) give a figure of FRF 246,023m. on 31st December 1920. From 1921 till 1926 figures provided are only estimates. Sauvy warned that the figures were full of pit-falls and that the real position would never be known, though earlier estimates by Rogers (1929) and Haig (1929) indicate a growing increase in total debt outstanding. By 1926 debt service expenditure was absorbing 53% of the budget, that is FRF 22,345.9m. out

[10] If gold convertibility were restored.

[11] see Golden Fetters, p.73.

[12] Sauvy (1984).

of a budget total of FRF 41,976.2m.[13]

Though 1925 was to mark the paroxysm of post-war financial crisis, in purely budgetary terms it was to register a significant improvement. In fact the largest budget deficit in the period 1920-36 was posted in 1923, largely a result of extra-ordinary expenditure associated with the Ruhr occupation. This foreign policy failure highlighted the illusion upon which French budgets had been prepared. Poincaré in his effort to restore financial stability consolidated the ordinary and extra-ordinary budgets. It should be noted that confidence had originally been undermined by Poincaré's Ruhr invasion and fear that the FRF might follow the mark. The *bordereau de coupons* a measure introduced by Poincaré to try and staunch tax evasion on gilt coupon payments also served to frighten capital. This measure was singularly inept given the government's funding needs.[14] The *bordereau* was revoked by the *Cartel* government and replaced by the *carnet de coupons* to be held by the individual rather than by a financial institution.

The following table records the movement in retail and wholesale prices over the period:[15]

	1919	**1920**	**1921**	**1922**	**1923**	**1924**	**1925**	**1926**	**1927**	**1928**	**1929**
retail	289	398	312	304	364	399	451	574	538	572	600*
whole sale	384	520	352	334	428	499	581	718	630	634	623

	1930	**1931**	**1932**	**1933**	**1934**	**1935**	**1936**	**1937**	**1938**	**1939**
retail	603	97.2	89.9	85.2	82.1	76.0	79.8	99.7	113.4	120.4 *
whole sale	543	462	407	388	366	347	405	563	640	680**

* retail prices are December figures and from 1919 to 1930, 1914 is used as the base year. From 1930 to 1939 the figures are annual averages using 1930: 100. ** The wholesale figures are annual average figures using an index of 45 commodities with July 1914: 100.

[13] see Statistiques (1963).

[14] For a contemporary reflection on the effect of such measures one may draw attention to the impact of the tax on "bund" coupon payments in 1988, a measure which had soon to be withdrawn because of its effects on the market.

[15] Figures from Sauvy (1984) pp.347 & 356.

The effect of the exchange crisis is well captured by figures in Rogers[16] which indicate that the rate of external depreciation ran well-ahead of the rate of internal depreciation, as recorded by the retail price index. Rogers pointed out that this was not consistent with the classical model of exchange rate determination, viz., that domestic prices would lead the process. This experience helped Pirou develop his so-called "psychological" theory of exchange depreciation which would today be recognised as an expectations-augmented forward looking model, which is in part self-fulfilling.

Poincaré's majority, however, lost the following election, in part due to the unpopularity of the *double décime*. The *Cartel des Gauches* disengagement from the Rhineland and the long drawn-out schedule of reparations payments fixed by the Dawes committee, staggered over 52 years or three working generations(!), dispelled the illusion of an immediate bounty arising out of German reparation obligations. The accounting counter-part, in the public psyche, in particular, of the government's extra-ordinary budget viz., reparations, was now clearly exposed as wanting.

One should note that budgets, when voted, were presented as nominally in balance from 1925 to 1932,[17] though final returns only indicated surpluses in the period 1926 to fiscal 1929-30.

Poincaré's "bear squeeze" of March/April 1924 was only successful for a short-while in stemming the financial crisis. By 1925, following the failure of the first Herriot government and the gradual unravelling of the *Cartel* majority, we witness a gathering financial storm. 1925 was to be a difficult year in any circumstances owing to the substantial chunk of public and floating debt maturing. Confidence, which was sorely lacking, was therefore crucial in ensuring a sufficient renewal of maturing debt. Though figures vary, Dulles (1929) gives a figure of FRF 22bn. for debt maturing in 1925,[18]- this sum was not included in the budget which presumably only included servicing costs on long and medium-term debt and not maturing liabilities, particularly short-term ones, which would be a treasury matter. The budget itself already included FRF 15bn. to service debt and a further

[16] see Rogers (1929); and chapter six of this thesis.

[17] see Sauvy (1984).

[18] Dulles (1929) p.184.

FRF 4bn. as pensions and indemnities.[19] Dulles rightly alluded to the number of *bons de la défense nationale* outstanding as a measure of public confidence, and though estimates vary[20] it is worth quoting her figures for illustrative purposes.

In January 1925 the number of *bons* outstanding was FRF 54,886m.[21] by August 1925 this had fallen to FRF 50,330m. There was a further drop to FRF 44,218m. in July 1926. Poincaré returned to office on 23/7/26. The outstanding stock of *bons* increased to FRF 49,079m. in December 1926 and had fallen to FRF 43,464m. in December 1927. However, this was probably accounted for by the funding operations conducted by the newly created *Caisse de Gestion des Bons de la Défense Nationale et d'Amortissement de la Dette Publique*. The *Caisse* allowed the government to take the financing and funding of short-term debt off-budget these liabilities were then secured by ear-marked funds, it also helped restore confidence in that it made it less likely that there would be a forced conversion. Haig's figures (1929) for *bons* outstanding agree with Dulles' (1929). Haig's figures include Treasury bills outstanding, but these were a small proportion of the floating debt. The total at end 1925 for the floating debt was FRF 48,128m. of which only FRF 2,393m. were Treasury bills.[22]

Rogers (1929) has constructed a table showing excess of emissions over reimbursements of *bons de la défense nationale* and short-term treasury bills.[23] In 1919 the figure was FRF 25,183m.; 1920: FRF 6,261m.; 1921: FRF 13,049m.; 1922: FRF -1,291m. Net withdrawals became quite precipitate during the whole Ruhr episode with heavy withdrawals over the whole period October 1922 to April 1925. This was reversed following Poincaré's "bear squeeze" which saw a return to a net increase in issues. This was short-lived, however. 1923, as a whole, registered net withdrawals of FRF 1,350m. 1924 registered net withdrawals of FRF 1,312m., with the most substantial amount occurring in the second half following the electoral victory of the *Cartel des Gauches*. 1925 was particularly bad with a total of net withdrawals of FRF 8,279m., "were they effectively

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[19] Dulles' source is Chéron's, Rapport au Sénat, Feb. 1926.

[20] see Sauvy (1984).

[21] Dulles (1929) p.186.

[22] Haig (1929) p.231.

[23] Rogers (1929) p.231.

swapped for Caillaux's exchange guarantee loan?" October 1925 saw a peak number of withdrawals at FRF 5,304m. This was the period of Caillaux's failed exchange guarantee loan which was issued during his tenure at the Finance Ministry under Painlevé. The Painlevé government fell in October and Caillaux was not re-appointed in the new Painlevé government. 1926 saw an excess of renewals over debt falling due of FRF 1,196m. Withdrawals reached a peak for 1926 of FRF 2,110m., in July, during the final crisis before Poincaré's returned to office.

Interest rates rose throughout this period, with the discount rate reaching its peak in July 1926. Poincaré put it up to 7.5%. The yield on the 3% *rentes* rose from 1920 to reach average annual inter-war peaks in 1925 and 1926.[24] The peaks in both the discount rate and the yield on the *rentes* translate respectively the government's acute treasury and exchange difficulties at the time as well as uncertainties concerning stabilisation, the domestic political situation, conversion of the debt, and the chronic fiscal crisis of the state.

The following table records annual averages for the yield on the 3% *rentes* and the annual average discount rate of the Bank of France.[25] The first line gives the yield on *rentes* and the second the average discount rate.

1913	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928
3.40	4.86	5.23	5.31	5.14	5.29	5.70	6.39	6.13	5.28	4.43
4.00	5.00	5.73	5.79	5.11	5.00	5.99	6.33	6.58	5.22	3.53

1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939
3.96	3.42	3.46	3.82	4.38	4.12	3.73	3.87	3.90	4.02	3.95
3.50	2.72	2.11	2.50	2.50	2.70	3.40	3.67	3.81	2.76	2.00

Figures for the note circulation certainly reflect the governments' untenable financial position. The second *Cartel* government, following the fall of the first Herriot government, had to ask parliament to raise the *double plafond*, partly to regularise an existing situation, highlighted by the previous government's breaching the ceiling on the note issue. This had been set at FRF 41bn. on September 28th 1920.[26] If we examine Rogers' (1929) figures

[24] Sauvy (1984) p.404.

[25] From Sauvy (1984) p.404.

[26] Haig (1929) p.210.

for the note circulation one sees that from July 1924 to April 1925,[27] when the official ceiling was raised to FRF 45bn., the "official" figures indicate that the note circulation was only marginally below the ceiling. In April, when the ceiling was raised, the published figures indicate a "sudden" increase in the note circulation of some FRF 2bn., perhaps demonstrating the degree of under-reporting of the note issue in official statements.

Using Sauvy's (1984) figures, the note circulation increased from FRF 40,726m. in January 1925 to FRF 49,873m. in December, a 22.46% year-on-year increase! The ceiling on the note circulation in April 1925 was raised by FRF 4bn. to FRF 45bn. and to FRF 51bn. in June 1925 and again in December! to FRF 58.5bn. The note circulation increases after 1920 required parliamentary approval, which may explain why increases were not sought sooner. Two modifications were brought to the *double plafond* in 1926. The first was in July 1926 when legislation was passed allowing the ceiling to be breached to the extent of the balance of the Morgan loan which the Treasury had surrendered to the Bank of France.[28] This was done so that the Treasury, whose coffers were empty, could secure working funds. The Bank of France had refused to accommodate the Treasury under any other circumstances.[29] The second amendment was the enactment of August 1926 allowing the Bank of France to breach the limit to the note circulation to the extent of bullion and foreign exchange purchased. This would ensure that the currency issued was fully-backed and effectively placed the franc on a gold exchange standard.

It is interesting to compare the increase in the note circulation during this period with the increase in Bank advances to the Treasury. The ceiling on advances had reached a post-war peak of FRF 27bn. in July 1919. This was to fall as a result of the François-Marsal convention which aimed at an annual FRF 2bn. reduction in advances. As a result advances were reduced to FRF 25bn. on January 1st 1922,- the note circulation in the year from January 1921 to December registered a fall of FRF 1.4bn.[30] The François-Marsal convention was not to be fully implemented though. On January 1st 1923 advances outstanding were only reduced by FRF 1bn. to FRF 24bn., and on January 1st 1924 the

[27] Rogers (1929) p.62.

[28] Haig (1929) p.210, footnote d.

[29] see Jeanneney (1976).

[30] Using figures in Rogers (1929), p.62.

reduction was only FRF 800m. to FRF 23.2bn. On January 1st 1925 it was reduced to FRF 22bn. The period from April 15th 1925, when the ceiling on advances was raised FRF 4bn. (on the same day and by an equivalent amount as the note issue was raised), to January 1926 saw the ceiling on advances rise to FRF 38.5bn. Poincaré re-activated the François-Marsal convention on January 1st 1927. The Treasury account of advances from the Bank of France was finally closed with the profits realised on the revalued gold stock of the Bank of France, when the franc was officially stabilized in June 1928.

If we look at the note issue from the decree of September 28th 1920, which set a limit to the note circulation of FRF 41bn.[31] and the law of January 1st 1925 which set the limit on advances at FRF 22bn. we can see that the former increased FRF 17.5bn. to December 1925, and that the latter increased by exactly the same amount![32] Essentially, the government had no recourse but to the printing press, given the difficulties of renewing debt falling due.

As we have already pointed out the actual budget deficit in fiscal 1925 was much lower than in previous years at FRF 1,507m., but it was the crisis of government and short-term funding difficulties which precipitated the run. This was evident in the foreign exchange market with the French franc spot rate depreciating between June and July against the dollar from 34.12 to 40.96 or 20%! The previous year's rate of depreciation was some 44% from 18.54 in January 1925 to 26.74 in December 1925. The rate of depreciation from January to July 1926 was 54.4%, viz., from 26.52 to 40.96. The FRF depreciated 121% against the dollar in the period January 1925 to July 1926.[33] As a measure of Poincaré's effect on confidence one should note that from July to August the FRF rose from 40.96 to 35.42 to the dollar, an appreciation of 13.5%. By December the franc was trading at 25.33, near its eventual stabilisation rate. This was an appreciation of 38.16% in five months![34]

Poincaré's stabilisation was effected in part by a psychological return of confidence, the market "rationally" discounted the benefits of his actions which translated into an

[31] see Haig (1929).

[32] Haig (1929) p.209.

[33] Spot rates from Wolfe (1951), Appendix, p.213.

[34] see Wolfe (1951).

immediate appreciation of the exchange rate.[35] The budget was passed before the end of the previous financial year. This was to be the case till fiscal 1931. This was an appreciable psychological and practical advance on the early post-war years when not only were budgets divided into ordinary and extra-ordinary elements, but also included a special budget *des dépenses recouvrables* (or recoverable expenses, viz., from Germany). The extra-ordinary budgets in the years 1919-24 accounted for the near totality of the budget deficit.

Sauvy gives the following figures:

	extra-ordinary and special budget deficit	**total budget deficit**
1919	-28,941	-26,688
1920	-17,513	-17,139
1921	- 9,104	- 9,275
1922	- 6,888	- 9,761
1923	-12,379	-11,806
1924	- 6,768	- 7,121

Of these budgets only that of 1922 was passed before the expiry of the previous financial year.[36] This meant that governments had to have recourse to provisional twelfths. In some years the budget was only passed after $^{7}/_{12}$ths had been voted. In 1924 a budget was not even passed and the 1923 budget was merely prorogued. This was due to the elections held in May 1924 and the unwillingness of the care-taker government to take any action. The future *Cartel* majority were unwilling to co-operate. Fiscal 1925 was to see the disappearance of the extra-ordinary budget as an item of expenditure, though revenue was still recorded under that heading. The 1925 budget, though not passed before the beginning of the financial year, was to record a far lower deficit than in previous years at FRF 1,507m.[37]

The years 1926 to 1930 were to be the halcyon days of French inter-war finance with quite substantial surpluses recorded. The tax increases introduced by Poincaré in 1926 resulted in net revenue increases. Thereafter the surpluses, culminating in the so-called

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[35] Sicsic (1992) has argued that speculation was destabilising.

[36] Sauvy (1984) p.9.

[37] Sauvy (1984) p.379.

"*Trésor Chéron*", allowed the fiscal burden to be reduced, in particular in fiscal 1930. This would be criticised later as having contributed to the deficits registered in the 1930s.

The following figures are given by Sauvy for budget surpluses:

1926	1927	1928	1929	1930
1088	217	3929	*	4934

Sauvy does not give a figure for 1929 owing to Tardieu's reform of the fiscal calendar. The 1930 figure covers a 15 month budgetary period.[38] Do these figures exclude reduction of advances by the Bank to the Treasury, which Poincaré made to resurrect the François-Marsal convention, thus understating the favourable position compared to previous years?

Poincaré's package of measures included various increases in indirect taxes, particularly on consumption, but also a one-off tax on the first transfer of real property (*taxe sur le capital immobilier*) which may have been a sop to the left, i.e., the radicals who were in his government coalition. However, the top marginal rate of income tax was reduced from 60% to 30%. In 1926 we certainly witness a very substantial rise in tax revenue. There may have been a "Laffer curve" revenue effect with lower marginal tax rates raising the relative cost of tax evasion and avoidance, aside from any stimulating supply-side effects. Tax revenue rose from FRF 34,768m. in 1925 to FRF 43,064m. in 1926, or some 24%. Germain-Martin would later be of the opinion that only in 1926 could one be certain that the budget comprised all rubrics of public expenditure.[39]

Excluding fiscal 1930 which enjoyed 15 months of revenue, revenue peaked in 1930-31 at FRF 50,794m. Not till 1938 was nominal revenue to rise above this.

Revenue in 1930 was based on the penultimate year's revenue (n-2), i.e., 1928. This was reformed in 1938 when tax returns were assessed on the previous year's earnings (n-1),[40] though Mouré states that it was reformed in 1935.[41] However, the onset of recession

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[38] Sauvy (1984) p.379.

[39] Quoting Germain-Martin (1936), "*En fait, malgré les efforts continus des Gouvernements successifs, c'est seulement en 1926 que l'ont peut avoir la certitude que le budget général englobait l'intégrité des dépenses publiques.*" p.64.

[40] see Sauvy (1984).

[41] Mouré (1991) p.189, footnote 139.

from 1930-31 saw a return to budget deficits. The n-2 rule probably acted perversely as a cyclical de-stabiliser as it meant that tax liabilities incurred during the year's of prosperity would fall due at the onset of depression, whilst the opposite effect would occur during the recovery.

Sauvy gives the following figures for budget deficits in millions of francs for the period 1930-38,

	revenue (total)	expenditure (total)	extra-ordinary budget deficit*	total deficit
1930-31	50,794	55,712		- 4,918
1931-32	47,944	53,428		- 5,484
1932	36,038	40,666		- 4,628
1933	43,436	54,945		-11,509
1934	41,070	49,883		- 8,813
1935	39,485	49,868		-10,383
1936	38,893	55,789	(- 9,122)	-16,896
1937	44,451	65,645	(-15,378)	-21,194
1938	54,653	82,545	(-18,799)	-26,792

* figures in brackets express the deficit on extra-ordinary budget account which is included in the total deficit. Figures given for revenue and expenditure are aggregate figures which include revenue and expenditure incurred on extra-ordinary account.

Looking at these figures it is interesting to note the remarkable rise in expenditure in fiscal 1933 and the inability of government to reduce expenditure in 1935 when deflation was pushed to its extreme by Laval. In fact Sauvy's figures indicate that the fiscal burden as a proportion of national income actually increased in 1935, pointing to the futility of the exercise, viz., national income was falling faster than the government could curtail expenditure given political constraints. Though 1934, when Doumergue was Prime Minister, registered quite a significant decrease in expenditure on 1933 due to decreed reductions. Another factor which these figures reveal is, as one would expect, that revenue was well down during the depression,- until 1938 when the economy began to pick-up under the impulse of war expenditure and Reynaud's supply-side measures as well as confidence in the Daladier government (reflected in the capital inflow). This was to last for two full years. One should also mention the lower real exchange rate, and the fact that the gold standard had been effectively abandoned, which allowed the authorities to abandon deflation.[42] As can be seen the very large deficits from 1936 were largely the product of extra-ordinary budgets to finance re-armament following the re-occupation of the Rhineland in 1936. And it is difficult to see how this could have been avoided, though the means of financing the deficit, principally by means of advances from the Bank of France was clearly unsound, though this could be justified on Keynesian grounds, i.e., in order to avoid a fall in demand caused by a rise in taxes. Instability probably precluded a large funding programme which would have raised interest rates. In the circumstances the time proven war-time expedient of resort to the printing press was probably the wisest option.

From 1936 we witness a very significant increase in the budget deficit. These had increased very substantially since 1933 when the deficits more than doubled on those recorded in the previous period. However, from 1936 the budget deficits took another step-increase from FRF -10,383m. in 1935 to FRF -16,896m. in 1936. These increases were essentially due to a rise in expenditure whilst revenue gradually fell under the impact of depression.

1936 saw the re-appearance of an extraordinary budget to finance re-armament. The deficit under this rubric, was FRF - 9,122m., against a total deficit of FRF -16,896m. In 1937 the deficit on the extra-ordinary budget was FRF -15,378m., against a consolidated budget deficit of FRF 21,194m. In 1938 the last full pre-war year the deficit totalled FRF -26,792m. of which FRF -18,799m. was accounted for by the extraordinary budget deficit. To give an impression of the extent to which funds were pre-empted by: debt payments; expenditure on the air-force (other military expenditure now being carried-off budget under a new rubric of extra-ordinary revenue and expenditure); and pensions, it is worth noting that in 1936 and 1937, respectively, these expenditure headings combined accounted for 65% and 79% of total expenditure! If one includes net extraordinary expenditure, figures indicate that in 1936 these items of expenditure represented some 99% of the expenditure total under the ordinary heading for budgetary expenditure and some 124% in 1937.

The difficulties which the Blum government encountered in financing its treasury position, particularly in the context of an increasingly expected devaluation is illustrated by its resort to an exchange guarantee loan. However, as Caillaux had experienced in 1925 this

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[42] see Eichengreen, Golden Fetters.

proved relatively unsuccessful. Governments from then-on had recourse to the old expedient of advances from the Bank of France. This had begun before the Popular Front government acceded to power.

The convention between the Treasury and the Bank of France of 18th June 1936 provided for an interest free advance of FRF 14bn. in order to regularise the system of covert advances which had been resorted to by previous governments, including Laval's. These covert advances were premised on an agreement with commercial banks. These would agree to discount Treasury bills on the understanding that the Bank of France would be willing to stand-by and assure them the liquidity to do so by agreeing to wider and more generous re-discount facilities for commercial paper held in the banks' portfolios. It was also understood that the Bank would be willing to re-discount Treasury bills held by the commercial banks.

Though Sauvy (1984) does not give a figure for 1936, the Bank of France balance sheet reveals a significantly higher portfolio of commercial bills than in 1934, viz., an increase in 1935 to FRF 6,195m. from FRF 4,343m. in 1934.[43] The June 1936 convention between the Bank of France and the Treasury also provided for a new line of credit (advances) of FRF 10bn. Interestingly article 6 of the convention stipulates that the additional issue would not be included in the total note circulation used as a basis to calculate the stamp duty which the Treasury levied on the outstanding note issue. This charge on the monopoly rent of the Bank of France was in lieu of *seigniorage*. However, did this dispensation mean that this additional note issue and those that were to follow - which were made under the same conditions - were not included in the note circulation?[44] Certainly figures supplied by Sauvy (1984) do not suggest that they were included;[45] however, the large gold outflows of the period would have reduced the note circulation *pari passu*. In fact the gold standard provided a virtual automatic sterilisation mechanism for the increased note circulation which helps account for the less inflationary characteristics of the financial crises of the mid 1930s than in the early 1920s.

Sauvy's figures indicate a year-on-year rise in the note circulation in 1936 from FRF

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[43] Sauvy (1984) p.393.

[44] see the statutes of the Bank of France.

[45] see Sauvy (1984) p.394.

81,112 to FRF 87,460 million, or 7.83%; in 1937 from FRF 87,335 to FRF 91,716 million or 5%; in 1938 from FRF 92,538 to FRF 100,145 million or 8.2% only in 1939 do we witness a very significant increase from FRF 110,000 to FRF 149,857 million or 36.24% - the latter increase is most probably due to the coming in effect of the convention agreed on 29th September 1938 which allowed the Treasury to draw on a line of credit of FRF 25bn. in case of war.

Looking at the growth of the total sight-liabilities of the Bank of France can also be a useful guide to the increase in liquidity and captures the very substantial increase in current account deposits from 1936 to 1937.[46] The Bank of France's sight liabilities grew by 12% in 1937;[47] 17.9% in 1938; and 20% in 1939. Lutfalla & Patat's figures (1986) for M2 are included in Appendix. These indicate a substantially similar trend.

The period 1935-39 was to witness constant recourse to the Bank of France as the only means of satisfying the government's tenuous Treasury position. Figures published in the Statistiques et études financières illustrate the treasury difficulties during this period.[48] If we look at the major sources of funds to cover the annual short-fall we can see that in 1936 the virtual whole was made up of advances from the Bank of France to the Treasury, viz., monetary creation. The so-called Treasury "*impasse*", or short-fall, needing to be financed is put at FRF 21bn. in 1936; FRF 30bn. in 1937; FRF 41bn. in 1938; and FRF 82bn. in 1939. In 1936 of the total "*impasse*" FRF 19bn. was covered by direct advances from the Bank of France, whilst Treasury bills were down FRF -3bn. The figures for 1936 are a telling record of lack of confidence, domestic borrowing was a mere FRF 2bn. whilst foreign loans were down FRF -1bn. In 1937 the direct advances from the Bank of France are recorded at FRF 12bn., FRF 14bn. was raised through domestic borrowing and FRF 2bn. from issue of Treasury bills. In 1938 FRF 10bn. was raised through loans, however foreign borrowing was down FRF -7bn. indicative perhaps of a lack of confidence and exchange rate uncertainty. The sale of Treasury bills in 1938 raised FRF 7bn. Advances from the Bank of France in 1938 are put at FRF -5bn., presumably due to reimbursements

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[46] One may wonder whether deposits were encouraged as a "window dressing exercise" in order to reduce the number of notes in circulation?

[47] Using figures from Sauvy (1984), p.393.

[48] see: (1959) supp., n.123 p.298-301.

made using the Bank's revalued gold holdings. In 1939 total borrowing amounted to FRF 40bn., FRF 24bn. internal and FRF 16bn. external, sale of Treasury bills raised FRF 16bn and direct advances from the Bank of France stood at FRF 15bn.

A law passed on 23 June 1936 set a maximum of FRF 20bn. to the Treasury bill issue. These could now be re-discounted at the Bank of France.[49] Such a practice would have been considered completely anathema during the 1920s.[50] In Moreau's memoirs there are long passages discussing the merits of various discount policies and the need to ensure that only sound commercial bills with three endorsements (acceptances) were used to back the note issue, viz., the traditional "banking school" argument which was supposed to regulate the activities of the banking division of the Bank of England.

The devaluation of September 1936 was used as an opportunity to realise the profits on the Bank of France's gold stock which was revalued at the new maximum par value of the FRF, viz., 49mg. of fine gold (at .900 fine). FRF 10bn. secured thereby would be used to set up an Exchange Equalisation Account, the *Fonds de stabilisation des changes*, and of the FRF 7bn. remainder FRF 6bn. were ear-marked to reduce the Treasury's outstanding balance of advances (debt) at the Bank.[51]

One of the first acts of the Chautemps government,[52] which succeeded Blum's first government, was to pass a convention with the Bank of France for a further FRF 15bn. in advances. The new Finance Minister G.Bonnet had found the Treasury virtually empty. This was followed soon after, on 21st July, by a revaluation of the Bank of France's gold stock at the previous minimum gold value of the Auriol franc, i.e., 43mg. Governments were increasingly to rely on debasement of the gold value of the currency and the paper profits realised in the operation as a major source of revenue. This effectively amounted to a tax on all credit outstanding as the gold value of debt/paper (the counter-part to credit) was reduced.

Realised profits on the Bonnet "revaluation" of the gold stock (which was the mirror-image of the "devaluation" of the franc) were used to set up a *fond de soutien des rentes* in

[49] Myers (1936).

[50] see Moreau (1954).

[51] Sédillot (1953) p.302.

[52] The Chautemps government lasted from 22/6/37 to 14/1/38,- see Appendix.

order to prop-up the price of gilts,- an attempt to enhance their attractiveness. The *fonds de soutien des rentes* was to be managed by the *Caisse de gestion*.... It may be said that the facility which this offered amounted to the ability to conduct open-market operations, though the specific legislation was not passed until June 1938 under the premiership of Daladier.

In March 1938, during the short-lived second Blum government, a convention was passed on 22 March increasing advances already agreed under the convention of 30 June from FRF 15bn. to FRF 20bn. And on 25th March a *Caisse Autonome de la Défense Nationale* was created, to keep funding costs for the re-armament programme off-budget. The Daladier government, which succeeded Blum's second government, with Marchandeau at the Ministry of Finance, had to arrange for a further advance of FRF 10bn. by way of a convention dated 14th April 1938. A decree-law of 12 November 1938 enacted under the premiership of Daladier, but with Reynaud now at the Finance Ministry (Marchandeau had favoured exchange controls and was replaced by Reynaud), provided for the revaluation of gold holdings of colonial banks. Article 4 of this decree clearly stipulated that the government could decide what proportion of the note issue should be included in the assessment for stamp duty on the note circulation, one may ask whether, "this was to reduce the published note circulation?" Otherwise it is difficult to see why the government should understate the circulation subject to stamp duty, as it reduced its revenue *pro tanto*. On the same day the Bank of France's gold was revalued at 27mg. per franc. The book-keeping profits were used to redeem the Treasury's account with the Bank of France for the period 18th June 1936 up to November 1938. The perpetual loan from the Bank of France to the Treasury, which had stood at FRF 3.2bn. since 1854/7,- which could be considered the purchase price for the monopoly note issue privilege,- was raised to FRF 10bn., with the balance of FRF 6.2bn. to be immediately credited to the Treasury account.

What is clear from the foregoing is that from mid-1936-on governments became increasingly dependent on advances from the Bank of France to remain solvent, though the trend had already become pronounced by early 1935. Taking the year 1937 new advances ear-marked for the Treasury, excluding profits credited to the Exchange Stabilisation Account and funds credited to the *fonds de soutien des rentes*, amounted to FRF 15bn., whilst the deficit in fiscal 1937 amounted to FRF 21,194m. And in 1938 total new funds advanced to the Treasury, excluding the write-off of previous advances outstanding when the gold stock was revalued on November 12th 1938, amounted to FRF 21.1bn. In 1938 the budget deficit stood at FRF 26,792m. Clearly governments were increasingly reliant on advances from the Bank of France to finance expenditure. Compared to the earlier period of chronic deficits, from 1919 to 1926 which was marked by a significant reliance on issue of floating debt, the period 1936-38 appears to be characterised to a greater extent by direct monetisation of the deficits.

Looking at the figures for the floating debt published by the Statistiques we see that it reached a peak at end-1920 at FRF 119,399m.[53] The series is broken, but stands at FRF 74,465m. at end-1928. The latter figure demonstrates the success of the Poincaré government and the *Caisse de gestion...* had in lengthening the maturity of the debt. The lengthening maturity of the debt is reflected in figures for total government indebtedness during this period. It increased from FRF 246,023m. to FRF 382,904m. These figures should dispel James's thesis (1992) that the success of the Poincaré stabilisation was due to any markedly improved debt position, rather the success rested on confidence and an improved Treasury position which was a direct result of real measures and confidence in the new coalition majority led by Poincaré.

The series published in 1959 (Statistiques) shows total public debt relatively static between 1934-36 in a range of FRF 423,300m. to FRF 424,000m. In 1937 it increased to FRF 468,658m. For 1936-38 we do not have a figure for the floating debt, so it is not possible to chart it. In 1938 total debt fell to FRF 423,518m. However, the figure is no longer comparable as it excludes inter-allied war debt and should therefore be adjusted upwards.

In order to understand the sort of deflationary shock transmitted by the devaluations first of sterling and then the dollar it is interesting to examine the nominal appreciation of the franc. This gives a clear picture of the impossible task which government had set itself. In 1931 with sterling devaluation the franc appreciated by 30.7% against sterling, in 1934 it appreciated 7.8%, in 1935 the rate remained static.[54] In 1936 following the devaluation of the franc it depreciated by 40.45%, in 1937 by 39.9% and in 1938 18.6% to stabilise in

[53] see: Statistiques (1963) p.1008; and (1959) p.302.

[54] see Sauvy (1984) for exchange rates.

1938. I have attempted to calculate approximate real exchange rates over this period.[55] These are reproduced in Appendix.[56] The figures indicate that the real exchange rate movements track the nominal rate and that the franc was clearly undervalued from 1920 to 1931 and that the franc was clearly overvalued in the period 1931 to 1936. This conclusion belies the McCloskey & Zecher contention that the law of one price should hold and be as applicable to traded and between traded and non-traded goods. From then-on, under the impact of serial devaluations, the franc again became significantly undervalued.

The period to 1936 demonstrates the significant adjustment effort which the French economy would have to make, somewhat alleviated by quotas and tariffs (though these would retard and hamper the adjustment process). Nonetheless, the rate of appreciation gives an indicator of the sort of deflationary impact imparted by sterling's devaluation, which was followed by some 25 other currencies. This in turn served to reduce economic activity and government revenue forcing further budgetary tightening which enhanced the perverse effects of pro-cyclical macro-economic policy.[57]

The extent of the nominal deflationary adjustment path is tellingly illustrated by the drop in national income at current prices. Sauvy's figures indicate that this fell from a 1929 high of FRF 334bn. to a nadir of FRF 221bn., in 1935, or a fall of 34%![58]

The depreciation from 1936 is a mark of the growing financial difficulties which beset government. The franc followed a fairly similar course against the dollar with a nominal appreciation of 36.3% in 1933, a further appreciation of 10.6% in 1934. In 1935 the rate remained steady. The September 1936 devaluation of the FRF brought a depreciation of 42.4% against the dollar, followed in 1937 by a further 37.4% fall, in 1938 the franc fell again by 25.42% and in 1938 the franc was down a further 15.6% against the dollar. Our calculations indicate that the franc was undervalued from 1920 to 1933 and overvalued from 1933 to 1936. With the depreciation of the franc from September 1936 it again became

[55] These use a cost-of-living index rather than a wholesale price index as the latter would be but a proxy for the exchange rate, see Sicsic (1992).

[56] see also Wolfe (1951) for estimates for the period 1924 to 1929, p.58 footnote 55.

[57] see also Eichengreen Golden Fetters.

[58] see Sauvy (1984) vol.II, p.29. Sauvy's measure of national income is of disposable income (*revenu partageable*). His measure of national income using constant 1930 francs indicates a real fall in national income over the period 1929-35 of 12.6%.

substantially undervalued.

Here one should mention Redmond (1988) who has argued that the use of bilateral nominal rates of appreciation and depreciation have led to an over-estimation of the impact of currency movements. He pleads for the use of trade weighted effective exchange rates. He argues that such measures of real exchange rate movements better capture the effects of exchange rate volatility and diminish the significance which has been attached to them in post-war literature.[59]

Redmond (1980) attempts to measure the effective exchange rate of sterling in the 1930s. He argues that his figures tend to infirm somewhat Nurkse's (1944) contention that floating exchange rates had been characterized by particular volatility. One should note, however, that currency volatility was but an epiphenomenon. The real volatility lay in government economic policies which diverged markedly in the period which he reviews, viz., 1931-1935, and in budgetary, and financial uncertainty. In his study Redmond (1980) adopts 1928 as a base year. One should note that this was the year which Hawtrey considered one of the most destabilising as a result of the Bank of France's significant gold acquisitions.

Redmond's second paper (1988) is an attempt to construct estimates of effective exchanges rates for the Gold Bloc and North America in the 1930s. Our critique of this paper is no less applicable to his earlier study.

One objection which he recognises is that using trade weights would tend to underestimate the impact of currency movements as these are not likely to be unrelated to exchange rate movements.[60] But, more significantly his analysis is conducted purely *ex post* whilst our attempt to describe a disequilibrium path rests on an *ex ante* analysis, viz., it fails to take account of the adjustment path. The lost output resulting from the overvalued

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[59] Quoting Redmond (1988), "...it has been argued that the main bilateral exchange rates overstate the extent of overvaluation of the four gold bloc currencies in the 1931-5/6 period and this is apparent whichever variation of any particular country's effective rate is considered since the whole range of indices calculated - from the highest to the lowest values - lies below the main bilateral rates in all four cases."(pp.401-403) and, "Moreover, the assertions made in the first major area in which conclusions have been derived - exchange rate stability - would seem to carry some weight also. In all six cases the effective rates were consistently less volatile and thus some doubt has been cast on the characterisation of the 1930's as a period of extreme exchange rate instability."(p.403). The six countries referred to are: Belgium, Canada, Holland, France, Switzerland, and the US.

[60] see Redmond (1988). One should note that Dick & Floyd (1992) would argue that to calculate a trade weighted effective exchange rate was meaningless as the trade balance constitutes a measure of the savings/investment gap. In their model the only meaningful real exchange rate is the ratio of non-traded goods prices to that in the country with which comparison is being made.

nominal and effective exchange rates may also translate in a lower "equilibrium" level of trade, e.g., no trade at all where firms have had to close down as a result of exchange rate induced drop in economic activity, thus again underestimating the impact of exchange rate movements.

It is significant that his analysis is classical in the sense that he examines trade flows and the exchanges from an external perspective, rather than in terms of its perverse effects on domestic macro-economic policy. Additionally, if one accepts the law of one price, trade flows need not occur for a downward impact on domestic prices and, hence, activity to arise, if one accepts supply-side rigidities. It is also intrinsic to our thesis that the path traced by nominal variables is paramount, particularly the exchange rate by forcing the domestic economy to import a lower nominal price level and the disequilibrium adjustment path that the economy is forced to follow as a result. The concept of real values is essentially a static "ex post" one, which does not capture the behaviour of economic variables through time.

Finally, if one looks at the figures which Redmond (1988) has calculated, using 1929 as the base "equilibrium" year, one sees that though effective exchange rates do display a smaller departure from "equilibrium" these are by no means insignificant. Finally, if one accepts the Dick & Floyd savings investment gap model Redmond's exercise is then futile.

The following are some of Redmond's (1988) figures most relevant to our analysis:[61]

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939
*	100	101.8	107.2	116.0	122.0	133.1	138.4	132.1	99.3	80.2	78.1
**	100	100.1	109.0	139.2	146.7	161.7	167.0	152.6	101.6	73.0	70.1
***	100	100.2	100.1	100.0	127.8	167.7	168.6	155.8	103.3	73.5	67.5

* measures the average bilateral exchange rate of the franc using trade weights for 29 principal trading partners; ** measures the evolution of the franc/pound nominal rate; *** measures the evolution of the franc/dollar nominal rate.

[61] Source: Redmond (1988) Table A-1.

Percentage change in exchange rates

(Jan. 1931 to Jan. 1936)

	U.S.A.	France	Belgium	Holland	Switz.	U.K.	C.E.E.R.
France	+69.0	000	+39.1	-0.3	+0.1	+65.4	+45.0
Belgium	+21.5	-28.1	000	-28.3	-28.0	+18.8	+3.3
Holland	+69.4	+0.3	+39.5	000	+0.4	+65.7	+45.0
Switz.	+68.7	-0.1	+38.9	-0.4	000	+65.1	+42.5
U.S.A.	000	-40.8	-17.7	-41.0	-40.7	-2.1	-7.5

Source: Redmond (1988) Table 1; C.E.E.R. is the composite effective exchange rate, for definition see Redmond.

One should note that the second table reproduced from Redmond describes a path for the Belgian franc which is different to that of its Gold Bloc partners this is because of the earlier devaluation of the belga in March 1935, whilst the table records exchange rate movements over the period Jan. 1931 to Jan. 1935.

Redmond's figures do not seem to warrant the conclusion that, "The second major area which has been discussed relates to the influence of exchange rates in depression and recovery. The most important conclusion here is the lesser role for exchange rate overvaluation in the Gold Bloc countries and in the US implied by the lower level of their effective rates (compared to the main bilateral rate)..."[62]

The impact of the devaluation of sterling on the Bank of France is visible in its treatment of its foreign exchange reserves which stood at FRF 25,686m. in 1930[63] which by 1932 were down to FRF 8,960m., falling to FRF 3,087m. in 1933 and finally following the dollar devaluation they were reduced to FRF 834m. in 1935.

During the same period the bank's gold holdings rose from FRF 45,911m. in 1930 to a peak of FRF 80,980m. in 1933 gradually falling off from then-on. This was the period of the so-called "gold avalanche" when France was considered a safe-haven for capital, particularly after the sterling devaluation and the onset of depression in the US. However,

[62] Redmond (1988), p.403.

[63] Sauvy (1984) p.393.

the gold inflow raises questions about the Bank of France's behaviour, which widely criticised by Hawtrey and Strakosch, in particular,- for a French perspective *vide* Aftalion. But what alternative was there for the Bank of France which had suffered losses of FRF 2.3bn. on its gold holdings when sterling was devalued?[64] Of course conversion into gold of foreign balances merely increased the attractiveness of the franc as it raised France's gold reserves *pro tanto* (is this why the Bank of France tried to disguise its gold holdings by making deposits with commercial banks?). Jeanneney mentions the "*compte Y*" held at the *Crédit Lyonnais* which amounted to some FRF 3bn. in 1933.

Sauvy gives the following figures for gold reserves as a proportion of sight liabilities, 1929: 44.19%; 1930: 51.07%; 1931: 56.21%; 1932: 78.44%; 1933: 79.28%. This steep increase is at the root of Hawtrey's accusation that the Bank of France was essentially sterilising world liquidity, or base money. One should recall that the Bank of France minimum reserve ratio had been set at 35% in 1928. The League of Nations Gold Delegation would recommend a reserve ratio of 25% in 1932.

In the foregoing section we have argued that French budgetary and monetary policy and difficulties in managing its treasury position were intrinsically linked. In the next section we will look more specifically at the revenue side of the budget and the extent to which budget revenue mirrors the trade cycle. Given the prevailing financial orthodoxy it will be appreciated that the lack of a concept of a cyclically adjusted budgetary stance compounded budget deficits and the economic depression.

BUDGET DEFICITS:

THE REVENUE SIDE AND ECONOMIC ACTIVITY:

In the first section, which took a close look at the expenditure side of the budget, we saw that much of budgetary expenditure was pre-empted by the legacy of the past, viz., war debt, pensions, and, in the early years, reconstruction expenditure, as well as the pre-existing debt which had been substantial before the First World War.[65] This made expenditure cutting

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[64] see Sandoz (1936).

[65] see Eichengreen Golden Fetters.

measures difficult to achieve. What can be said for the revenue side of the account? How heavy was the fiscal burden, could it have been increased? We will also take the opportunity to track the economic cycle through the various sources of budgetary revenue.

The revenue side of the equation can be used as a pointer to recessionary tendencies in the French economy. Both the business turnover tax, *taxe sur le chiffre d'affaires*, and the tax on *opération de bourse*,- which from a budgetary perspective was insignificant,- track well the progress of the recession. Both rise in the period 1928-30, falling very significantly through to 1937-38. Despite and because of Laval's deflationary programme it is interesting to note that fiscal and total budgetary revenue peaked in 1935 as a proportion of national income.[66] This was because of the more rapid fall in nominal national income.

The most significant tax which came into force during the war was the general income tax *impôt général sur le revenu*. This first came into effect in 1916 with a general rate and was completed in 1917 with the introduction of four separate schedules.[67] The legislation was originally passed on 15th July 1914. The issue of the income tax, largely the work of Caillaux, had sparked controversy during the pre-war decade and the mooted capital tax had to be shelved. The revolutionary taxes (which were designed to be non-inquisitorial), the "*quatres vieilles*," had rested on visible external signs of wealth, e.g., the number of external windows, these were now allocated as revenue to local government.

The income tax was reformed in the period 1919-20 and an additional new tax on income, *impôt sur le revenu*, differentiated according to specific source, was introduced. Specific income tax was levied according to variable schedules (*cédules*) according to source, e.g., unearned, earned, agricultural, etc... On top of this a general income tax was levied on net aggregate income, viz., the *impôt général sur le revenu*.[68] Income was calculated according to the penultimate (n-2) year rule, in order that forecast revenue could be based on an accurate assessment of revenue. Indirect taxes appear to have been levied as income was spent - this may well apply to the business turnover tax too - which would explain the lag in income tax receipts *vis-à-vis* the economic cycle, whilst indirect tax revenue accurately mirrors economic activity.

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[66] Sauvy (1984) pp.88 and 101.

[67] see Haig (1929).

[68] Sauvy (1984) p.80.

The very large budget deficit registered in 1919, which was due essentially to military and reconstruction expenditure, highlighted the need for additional sources of revenue.[69] As a result, along with the new specific income tax, a business turnover tax, the *taxe sur le chiffre d'affaires*, was introduced. A variant had been introduced in 1917 under the name, *taxe proportionelle sur les paiements*. However, under Clémenceau's Finance Minister, Klotz, the business turnover tax was introduced in December 1919.[70]

Haig (1929) estimated that tax-collections (in 1913 francs) did not increase above pre-war levels until 1921 with the introduction of the turnover tax, which also had the advantage that tax receipts were automatically indexed to the rise in domestic prices. Referring to the turnover tax, "This tax had proved and was to prove in the future one of the best sources of revenue, and had a special importance because its yield increased with rising prices."[71] Dulles (1929) pointed out that the socialists, "had pledged themselves to abolish this tax and to lighten indirect taxes generally." They attributed the high cost of living to this tax. However, the *Cartel* backed-off from abolishing it when they got into power in 1924.

During the period 1920-23, before the Ruhr debacle and German hyper-inflation, there were high expectations of reparations payments. As we have seen this rather deferred any effort to take stock of the real state of France's public finances, though the left did continue to press for a capital levy and there was some talk of a forced conversion of the debt (the latter operation formed part of the Belgian stabilisation of 1926).[72] The first post-war financial crisis which reached its climax in March 1924 and the failure of the Ruhr invasion illustrated the need to raise revenue, rather than have resort to borrowing and particularly short-term borrowing which was the major source of financial instability. In order to break the fiscal dead-lock Poincaré proposed an across-the-board rise in taxes of 20%, the *double décime*. The *double décime* aimed at raising FRF 6bn. and according to Bernard (1975) the Morgan loan was conditional upon the tax being passed.[73]

The *double décime* was passed in the Chamber of Deputies on 24th February. On the

[69] see section I of this chapter.

[70] Sauvy (1984) p.81.

[71] Haig (1929) pp.361-62.

[72] Yeager (1981).

[73] Bernard (1975) p.134.

same day the "*chambre bleu horizon*" passed a measure to ensure that unearned income was properly recorded and could therefore be taxed. This was the so-called *bordereau de coupons*. This official register of coupon payments was to be held on behalf of the individual by a financial institution. This measure probably had a negative effect on confidence.[74]

The *bordereau de coupons* may well have been passed to make the *double décime* more palatable. The *Cartel* opposed the *double décime* as it implied a rise in indirect taxation. The tax was one reason for Poincaré's subsequent electoral defeat in May 1924. The *Cartel* government headed by E.Herriot abandoned the *double décime*.

Herriot bowing to pressure from his constituency of small savers [75] also abandoned the *bordereau de coupons*. However, in the short-lived Briand government of March/June 1926 Finance Minister Raoul Péret introduced, in April 1926, the *carnet de coupons* instead. This was a register of coupon payments which had to be held by the individual. R.Péret, who also commissioned the Sergent committee report, had introduced tax increases and clearly it was necessary to reinforce measures to levy unearned income whilst other taxes were being raised. Poincaré was to revoke the *carnet de coupons* on 4th August 1926. This probably served to restore confidence as did the creation of the *Caisse d'Amortissement* which put paid to fears of a capital levy or a forced loan, and along with the accompanying fiscal measures helped prompt capital inflows.[76]

The Briand/Péret government fell on 15th June 1926[77] and was followed by a three week Briand/Caillaux government which fell when Caillaux asked for decree-making powers in order to stabilise the financial situation (by implementing the Sergent committee report). President Doumergue (1924-31) asked Herriot, who remained the leader of the largest parliamentary group and headed the *Cartel*, to try and form a government. This lasted one day, from 20-21st July 1926! This demonstrated that the parliamentary majority elected in 1924 had swung round towards the centre and opened the way for President Doumergue to summon Poincaré.

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[74] In recent years we had a vivid illustration of the possible impact of such a tax when the German authorities introduced, in 1988, a withholding tax on bond income. Capital outflows from Germany to Luxembourg totalled DM 120bn and the tax had to be abandoned (source: Financial Times 17/8/91).

[75] Sauvy (1984) and our chapter on the French polity.

[76] Sauvy (1984) p.85.

[77] Bernard (1975) p.247.

The Poincaré government presented a fiscal package aimed at restoring confidence and raising revenue. The top marginal rate of income tax (*impôt général sur le revenu*) was reduced from 60% to 30% and the *carnet de coupons* was abolished. A new property tax was introduced, the *taxe sur la première mutation*. This was a 7% tax on the first transfer of real property.[78] This wealth tax was probably, in part, a sop to the radical-socialists who were present in Poincaré's oecumenical coalition government. The tax on commercial and industrial profits (*bénéfices industriels et commerciaux*) was raised from 10% to 15%, the tax on agricultural earnings was raised from 7.2% to 12%. The *contribution foncière*, a tax on property based on imputed rent was raised from 12% to 18%.[79] The tax on domestic securities and registered foreign securities, *valeurs françaises et valeurs étrangères*, was raised from 12% to 18% and on foreign non-registered securities, *valeurs étrangères non abonnées*, was raised from 14.4% to 25%. The tax on non-commercial profits, *bénéfices non commerciaux* was raised from 7.2% to 12% and the tax on office holders of various sorts, *charges et offices*, was raised from 9.6% to 15%.

As we have seen in our previous section budgets were in surplus from 1926 to fiscal 1930. This allowed a reduction in taxes in 1929. As a result income tax levied on wages and salaries (*traitements et salaires*) was reduced from 12% to 10%, though the top marginal rate of tax on aggregate net income (*impôt général sur le revenu*) was raised to 33.3%. Expenditure was also increased, e.g, war pensions. Thus began the period of fiscal largesse following the discovery of the so-called "*Trésor Chéron*" - Finance Minister from 11 November 1928 to 21 February 1930.[80]

The creation of the *Caisse Autonome d'Amortissement*, under Poincaré by constitutional amendment put-paid to fears of forced conversion and ensured ear-marked revenue to gradually retire short-dated floating debt. Poincaré's measures were also accompanied by economy measures.

In order to reduce "crowding-out" and stimulate markets P.Reynaud as Finance Minister (he shared responsibility with Germain-Martin who was Minister for the Budget),[81]

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[78] Sauvy (1984) p.85.

[79] Sauvy (1984) p.389.

[80] Sauvy (1984) vol.1 p.404.

[81] see Sauvy (1984).

in April 1930, reduced the tax on domestic securities from 18% to 16% and on foreign securities from 25% to 18%,[82] whilst the tax on stock market operations, *opérations de bourse*, was reduced by half. The *impôt foncier*, (property tax) was also reduced, from 18% to 16%.

During the recession emphasis was put more on reducing expenditure. This was because it was thought that higher taxes would "crowd-out" private expenditure and so compound the recession.[83]

Under Doumergue in 1934, with Germain-Martin at the Finance Ministry expenditure cutting measures of various sorts were introduced (see previous section).[84] At the same time, in May 1934, various fiscal reforms were implemented which actually reduced certain taxes.[85] These reforms aimed at simplifying fiscal legislation.[86] Germain-Martin recorded that as revenue increases could not be expected the burden had to fall on reductions in expenditure this would be accompanied by a fiscal reform which aimed at reducing the tax burden in order to assist economic recovery. Germain-martin implemented these measures by decree. On the expenditure side war pensions were reduced.[87]

Specific income tax schedules were reduced along with general income tax which was reduced from 36.76% to 24%. The tax on coupon payments on registered nominee bonds *valeurs nominatives* was reduced from 17% to 12%. Income earned on bearer bonds *valeurs mobilières au porteur* was doubled to 24%. The tax differential was obviously aimed at discouraging tax evasion. The reforms also aimed at somewhat reducing the complexity of the tax system and sought to compensate revenue lost through cuts by means of better

[82] Sauvy (1984) p.86.

[83] see Germain-Martin (1936); and chapter five of this thesis.

[84] Germain-Martin was Minister of Finance in three governments from 4 February 1934 to 31 May 1935. This only confirms Olé-Laprunne's (1962) thesis that despite political "instability" the degree of stability as measured by individuals holding certain portfolios and re-appearing in government was far higher.

[85] Sauvy (1984) p.153 vol.1.

[86] Sauvy (1984), ibid., quoting "*Projet de Loi du 29 Mai 1934.*"

[87] Quoting Germain-Martin (1936), "*Ne pouvant espérer d'une fiscalité accrue, il n'était d'autre méthode que d'imposer des économies massives et de tenter, par une réforme fiscale sérieuse, des allégements fiscaux pour aider à la reprise des affaires. Ainsi on voulait faciliter la préparation du budget de 1934 et des budgets avenirs qui étaient menacés par les conséquences des lois sociales et l'accroissement continu de la retraite du combattant.*" p.260.

enforcement of existing taxes. Net revenue loss was estimated at FRF 2bn., whilst compensatory surcharges were estimated at FRF 600m. and FRF 1.3bn. was to be gained from stricter enforcement of the tax code *répression des fraudes*.[88] Under Flandin there was a pause and deflation was abandoned. The budget neither aimed to raise revenue nor reduce expenditure. The resultant was a substantial budget deficit. The deficit in 1935 was FRF 10.4bn. This is the period during which the Treasury had to renew its lapsed policy of indirect advances from the Bank of France. Flandin also encouraged cartelisation[89],- it is said that he was influenced by Roosevelt's New Deal.

The final attempt at deflation, under Laval, was distinguished more by economy measures with an all round reduction in expenditure of 10% including bond coupon payments. The terms of the Caillaux 4% exchange guarantee loan were modified, by decree, suspending the exchange guarantee. This may well help explain the subsequent failure of the similar Blum loan.[90] Taxes were increased by some FRF 1.2bn. with a rise from 17% to 24% on French domestic securities and registered foreign securities. The tax on foreign securities was raised from 20% to 25%. Income tax was also increased by 25% on revenue from FRF 80,000 to FRF 100,000 and 50% on income above FRF 100,000.

From 1936 total budget revenue shortfalls are increasingly due to a rise in expenditure carried-off budget and financed to a significant degree by recourse to the Bank of France for advances. The Blum government replaced the *taxe sur le chiffre d'affaires*, under legislation of 3rd December 1936, by a once only *taxe à la production*. This tax on production was set at 6% on goods and 2% on other items. The previous *taxe sur le chiffre d'affaires* had discriminated in favour of integrated production units. During the Chautemps government, which followed, the tax on securities, *valeurs mobilières*, was raised. But, from 1936 on it was clear that total budgetary expenditure could not hope to be covered solely by revenue raising measures. In the time-honoured fashion a substantial proportion of expenditure, mostly on re-armament was carried-off budget, being considered exceptional and aimed at the protection of the nation. In the circumstances it was considered appropriate that it be financed through borrowing. In this way the sole burden of re-armament would not fall on

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[88] Sauvy (1984) vol.1, p.154.

[89] see Jackson (1985).

[90] Sauvy (1984) vol.1, p.213.

the present generation.[91] Though in theory the argument is sound if financed by borrowing, in practice, it meant very substantial reliance on increased advances from the Bank of France and concomitant increases in the note circulation, particularly in 1936. This further reduced the attractiveness of holding government paper.

Looking at government revenue what is immediately striking is that income tax should, despite very high notional marginal rates, account for something under 20% of aggregate revenue.[92] One should note that, despite a very high marginal top rate of income tax and a great reluctance to countenance an increase in the fiscal burden amongst the electorate (cf., the unpopularity of the *double décime*), comparing the relative fiscal burden in France with that in the UK the burden in France was far lighter. A.Maddison has published some indicative figures.[93] The figures are for total government expenditure as a percentage of GDP at current prices. In 1913 for France this stood at 9.9% of GDP compared to 13.3% in the UK. In 1929 at 12% in France and 23.8% in the UK. And in 1938 at 21.8% in France and 28.8% in the UK. These figures would suggest that there was significant room for increasing the fiscal burden, though one should note that government expenditure is not equal to the fiscal burden. Given the higher level of borrowing in France the actual fiscal burden in France, when net borrowing was increasing, would have been lower than figures for government expenditure would suggest. However, one should mention that the degree of state welfare provision was much higher in the UK, since Lloyd George's reforms, and to compare like-with-like one would have to subtract higher social expenditure from the UK figures.

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[91] Though if one accepts the Ricardo/Barro hyper-rational "equivalence theorem" financing expenditure either by borrowing or by an increase in the present fiscal burden would be neutral in its effects. This model has been extrapolated to take account of inter-generational transfers and avers that, if one accepts the postulate that present economic agents include in their welfare functions the consumption of their progeny, bond finance would have an equivalent effect on present consumption as an increase in taxes as economic agents would reduce present consumption so as to make an inter-generational transfer net of future tax liabilities. However, the very reason that bond finance is often resorted to is to try and transfer the fiscal burden on to future generations. It seems to us that only God's rate of time preference and consumption could be so abstract and altruistic (atemporal) as some of these "equivalence theorem" models would purport. In fact the idealised Platonic abstract essentialism (what Hodgson 1993 dubs "typological essentialism") of liberal economics here reaches its apogee and the individual now loses all his characteristics *qua* individual and becomes an infinite timeless abstraction. Ricardo himself seems to have recognised this and that in practice economic agents would not fully discount future tax liabilities, i.e., gilts would constitute an increase in net wealth.

[92] Sauvy (1984) pp.386-387.

[93] see A.Maddison (1984).

Nevertheless it is apparent, from the political debate about methods of increasing revenue, that there was an intractable dead-lock between the right which favoured increases in indirect taxes and reductions in expenditure, whilst the radical-socialists, and socialists lent more towards some form of capital levy. This dead-lock, which Poincaré attempted to circumvent by means of the *double décime*, was very damaging. By 1926, however, Poincaré felt strong enough to abandon his former policy of even-handedness to introduce measures aimed at restoring confidence.

Whether or not there was room to increase the fiscal burden is not a question which can be determined objectively by a simple comparison of relative fiscal burdens, but which is highly subjective and dependent upon political realities.[94] With hindsight it could be argued that it was just as well that there was an institutional dead-lock on the issue of raising taxes as in the early 1920s it could well have reduced the pace of reconstruction and dampened demand, whilst in the 1930s it would have enhanced recessionary tendencies.

As we argued at the outset of this section, an analysis of the revenue raised under the main budgetary headings can help track the state of the French economy, though fiscal revenue does not track the dip in economic activity in 1921, this is most probably because of the rise in taxes in the period 1919-20,- indirect taxes were raised in 1921. However, budgetary revenue clearly records the downturn in economic activity from 1930 onwards. The tax on stock exchange operations is a very telling indicator with revenue slackening in 1929-30 to FRF 622m. from a peak of FRF 630m. in 1928,- in 1930-31 it falls precipitously to FRF 173m. It reaches its nadir in 1932 at FRF 87m. picking-up in 1933 to FRF 149m. Falling again in 1934 (political uncertainty and deflation were probably instrumental here) to FRF 116m. In 1936 revenue was up to FRF 187m. and in 1937 to FRF266m. Revenue from the tax on securities, *revenu des valeurs mobilières*, also registers a dramatic drop from a peak of FRF 6.957bn. in 1929-30 to FRF 1.932bn. in 1932![95]

Indirect tax revenue, *contributions indirectes*, which acts as an indicator of consumer demand also follows a similar pattern. Similarly, the business turnover tax, which may be thought to act as a proxy for industrial activity and comparative profitability over time,

[94] see our chapters on: "The Nature of Financial Orthodoxy" (chapter five); and, "The Political Context" (chapter one).

[95] For data see Sauvy (1984), pp.386-387.

behaves in a similar fashion. Dropping from a peak of FRF 12.4bn. in 1929-30 to a low of FRF 5.15bn. in 1932, rising really quite gradually with relapses, registering sharp increases in 1938 from FRF 7bn. in 1937 to FRF 9.8bn., and FRF 13.5bn. in 1939. The significant improvement in 1938 and 1939 is most probably due to the stimulus given by re-armament and Reynaud's supply-side policies, in particular the relaxation of the 40 hour week legislation, e.g., abolition of the 8% tax on overtime work.[96]

Taking A.Maddison's GDP data it can be seen that budget revenue rather accurately tracks economic activity.[97] In 1919 to 1920 GDP increased sharply from 75.2 to 81.8 (using 1913 as base year), bolstered by heavy reconstruction and military expenditure and a record budget deficit.[98] Activity dips in 1921 as taxes are raised, the François-Marsal convention came into operation and world commodity prices collapsed, undoubtedly affecting agricultural income. As a result GDP dropped to 80.5. Activity picks up quite sharply from 1922 to 1923 from 93.1 to 98.1. Then under the *Cartel* GDP remains quite flat dipping again in 1927 from 110.7 in 1926 to 109.4, due to the deflationary effects of stabilisation and the slight rise in the fiscal burden.[99] However, renewed confidence, budget surpluses, falling interest rates and a relatively undervalued currency ensure two good years with activity rising to 115.7 in 1928 and to 125.8 in 1929. From 1930 economic activity falls with 1930 registering 122.0 with the rate of fall accelerating to 112.0 in 1932 from 117.0 in 1931. In 1933 activity picks up to 117 and remains steady through to 1935 when the Laval deflation reduced activity with GDP recorded at 113.2, though Sauvy (1984) registered an increase in activity from May 1935 to June 1936. From 1936 to 1937 activity rises from 114.5 in 1936 to 120.8 in 1937,- following the devaluation. Activity in 1938 remains flat at 120.8 (due to supply-side bottlenecks?) and then in 1939, the last year before actual hostilities, activity rises to 125.8 (back to the level achieved in 1929).

The record of direct tax revenue which was levied on an n-2 basis, and is therefore a lagging indicator, similarly reflects the movement in economic activity with the two worst years recorded in 1935 and 1936. Direct tax revenue reaches a peak in 1929-30 at FRF

[96] Sauvy (1984) p.88, vol.3.

[97] A.Maddison (1982) p.174.

[98] Sauvy (1984) p.379.

[99] see Sauvy (1984) for figures.

11bn., then dips in the two following years. In 1932 it falls from FRF 10bn. recorded in 1931-32 to FRF 8.85bn. in 1932. Falling again to FRF 7.7bn. in 1933, stabilising in 1934. It drops quite precipitously in 1935 to FRF 6bn. and to FRF 5.7bn. in 1936. Direct tax revenue then picks up at FRF 6.8bn. in 1937 to rise substantially in 1938 to FRF 9.245bn. and FRF 11.43bn. in 1939.[100]

[100] source: Sauvy (1984) pp.386-387.

CHAPTER 5

THE NATURE OF FINANCIAL ORTHODOXY

"Comment les Français qui se piquent, avant toute chose, de bon sens et de clarté peuvent-ils admettre que pour une Nation comme pour un individu il ne doive pas y avoir équilibre entre ce qu'ils donnent et ce qu'il reçoivent?"[1]

The previous chapters have aimed at lending an historical perspective to French currency experience during the 1930s. This experience is of particular importance to the subsequent debate, as it coloured the attitude of policy-makers, informed opinion and the general public. As this chapter will demonstrate there was a broad consensus in favour of retaining the exchange parity of the franc which had been so hard won during the Poincaré stabilisation (July 1926 to June 1928).

We will first allude to the theoretical model underpinning official policy and particularly the ultra-orthodox views of the Senate Finance Committee headed by the radical politician, Caillaux. Germain-Martin, Finance Minister, politician, and professor at Science-Pô. also subscribed to these views and was one of the most authoritative commentators. F.Jenny, financial editor of Le Temps (the precursor of Le Monde), also subscribed to the uncompromising orthodox view. Le Temps was owned by no less a figure than François de Wendel, the head of the *Comité des Forges*,[2] who was also a Regent of the Bank of France and a leading political figure of the centre-right within the *Fédération Républicaine*.

Drawing from an analysis of the contemporary press and official documents one can clearly adumbrate a theoretical model, redolent of the views expressed by present-day supply-side economists, and which in the 1920s had been associated with R.G.Hawtrey, prolific author on financial matters and one-man head and sole member of the UK Treasury's

[1] Germain-Martin (1936) p.257. Anyone used to the supply-side rhetoric of the 1980s will recognise this immediately.

[2] see J.-N.Jeanneney (1976).

Financial Enquiries Section.[3] These views were broadly described as the "Treasury view." However, before we proceed a substantial difference in tone should be noted between articles published in the press and official, internal policy documents. The newspapers were always far more outspoken and confident about the need to maintain parity with gold and the ability of the authorities to do so, whilst we find that internal policy documents grew increasingly pessimistic about the prospects of maintaining the Gold Bloc and were not unwilling to contemplate devaluation, particularly if concerted with the UK and US.[4]

As we will go on to demonstrate feelers and negotiations had already been afoot with the US before the formation of the Popular Front government in 1936, as far back as mid-1935! Mouré (1991) records that Flandin as Prime Minister had already suggested a stabilisation agreement in January 1935. Eichengreen suggests that this included a devaluation of Gold Bloc currencies.[5] These earlier initiatives, in part, exculpate the Popular Front from sole blame for the 1936 devaluation, a charge with which the right tended to smear the left.

We hope that a description of the underlying orthodox view will illustrate that it was a well thought-out analytical model, by no means devoid of logical consistency and cogency. This should dispell the view commonly associated with Sauvy (1984), and later reiterated by Kemp (1972) and Redmond that France was characterised by unbelievable financial ignorance.[6] The latter erroneous appreciation can only be ascribed to Keynesian prejudice or ignorance of the original literature. In fact the model to which French policy-makers on the whole adhered is one which would immediately be recognised by a new classical macro-economist imbued with such notions as: the Laffer curve; emphasis on the supply-side;

[3] Hawtrey's difference with French policy-makers centred around his emphasis on the need for a stable nominal price framework, whilst French policy-makers found this adherence to currency principles anathema. To them it smacked of managed money. French policy-makers, and particularly the Bank of France, adhered to banking principles which dictated that perverse pro-cyclical economic policies be followed by government.

[4] see chapter eight of this thesis.

[5] For references see Mouré (1991) pp.230-235; and Eichengreen (Golden Fetters) p.378. There is some inconsistency between these sources. Mouré argues that Flandin wanted the British to stabilise their currency as sterling weakness was jeopardising his reflationary experiment, as we know this would be the catalyst for the Belgian devaluation in March 1935. Eichengreen states that Flandin's approach included a proposed devaluation of the Gold Bloc currencies accompanied by trade liberalisation measures as a *quid pro quo* for British assent to a stabilisation agreement.

[6] see Redmond in, Broadberry & Crafts (1992) p.368, footnote 44.

efficient markets; and the Ricardo/Barro equivalence theorem. However, what is missing in the contemporary French analysis is a feel for the macro-economic dimension. This is also a reflection of the gradual process of government accountability toward the domestic economy, which would be completed by the second world war and memory of the depression. In the years following the end of the Second World War both factors provided fertile ground for Keynesianism. It is no coincidence that explanations for the variance in economic activity before the Second World War were referred to as trade cycle theory. In official papers and the press we find a constant obsession with the exchanges, the balance of payments, but little emphasis on the cumulative perversity of deflationary policies, nor a willingness to contemplate a self-correcting cyclical fiscal deficit.

At the outset, it is essential to note that the official and public perception of the early post-war currency experience had clearly associated inflation with a depreciation of the currency, with the direction of causation perceived to run from the latter to the former. The reluctance to contemplate devaluation was particularly acute in a nation of small savers and which, compared to the UK, was still rural. The party which best represented this constituency in the French Chamber of Deputies was the radical-socialist party, a hinge party, *parti charnière*, which along with the smaller *gauche radicale* constituted an essential ingredient of any coalition, whether of the centre-right or centre-left. Post-war inflation and depreciation was a resultant of war finance and fiscal profligacy. Subsequent debasement of the gold franc was but a *de facto* recognition of the depreciated purchasing power of the franc. However, this view did not register as sharply with public opinion as did the experience from 1924 to 1926 when it was thought that the depreciation of the currency on the exchanges had led and resulted in the marking up of domestic prices. A similar argument had been adduced by K.Helfferich to explain the depreciation of the mark during Germany's hyper-inflation. This had been partly for political purposes, in order to blame hyper-inflation on reparations transfers.

In France G.Pirou was the foremost exponent of the so-called "psychological" explanation of the depreciation of the franc and inflation.[7] His thesis, in essence, amounts to an expectations augmented view of monetary depreciation with the falling exchange rate leading a cumulative process driven by internal and expected internal depreciation. The

[7] see also Dulles (1929) in chapter four of this thesis.

process was cumulative with inflationary expectations fuelled by the fiscal crisis of the state and the constant need to refinance short-term Treasury bills falling due. When these could not be consolidated and renewed at a sufficient rate the Government's only recourse was to ask the Bank of France for additional advances and Parliament to raise the *double plafond* on Bank advances to the state and the currency issue.[8] Such action further undermined confidence, as real tax revenue in gold terms fell and the process became cumulative and accelerated. The cumulative process was halted for a short while in March 1924 when Poincaré attempted to raise taxes across the board, the *double décime*,[9] and squeezed the bears (bear raid) by buying francs with the proceeds of foreign bank loans, driving up the forward franc forcing speculators to cover short positions and so driving up the exchange rate. Speculators or bears, who given the circumstances might be said to have been acting rationally,- it is only with hindsight that one may call them speculators,- who had gone short of francs were badly burned and as a result the forward discount against the franc was reversed and the franc appreciated considerably on the exchanges.

Poincaré lost the subsequent 1924 election, in part as a result of the *double décime* which the radical party had strongly opposed. The radicals had particularly opposed the rise in indirect taxes which it implied. As we have tried to show in chapter three it was the inability of the radical government to deal with the fiscal deficit and lack of confidence, which led to a renewed flight from the currency. The subsequent 1924 *Cartel des Gauches* government had inherited a particularly unfavourable position with a large quantity of Treasury bills falling due and the franc was to depreciate anew. This historical experience is crucial to an understanding of the subsequent reaction of the French political and financial establishment against any further debasement of the currency. Eichengreen shares this opinion.

Raymond Poincaré had succeeded in stabilising the franc, because he renewed confidence, presided over a cross-party cabinet which included six former prime ministers from the radical-socialist leader, E.Herriot to L.Marin leader of the *Fédération Républicaine*, and had a fiscal programme to balance the budget with revenues deliberately earmarked to redeem the floating debt (putting paid to a capital levy or a forced conversion operation), and

[8] see Rogers (1929) in chapter three of this thesis.

[9] see Sargent (1983); and Eichengreen & Wyplocz (1986).

his policies saw a return to a favourable balance of payments on current account. The budget was also passed at great speed. As we will see when the franc was subsequently devalued all these criteria were lacking, the *Front Populaire* was obliged from a domestic perspective to initiate a devaluation "*à chaud*,"[10] though it was well co-ordinated internationally.

An important point to note about the Poincaré stabilisation is that the proceeds from the revalued gold stock were credited to the Treasury which used these balances to extinguish its debt to the Bank of France. This debt had been contracted over the immediate post-war period. In particular after the run on the franc had become acute following the Ruhr invasion,- which had been ordered by a previous Poincaré government (January 1922 to March 1924). The increased floating debt, accumulated since the war had, in significant proportions, been used to finance government current expenditure. The other major rubric of expenditure was the finance of post-war reconstruction.

Through the revaluation of gold stocks governments had discovered a novel way of regularising previous inflation which in other circumstances would lend a false semblance of a return to a sound treasury position, e.g., the Blum devaluation, whilst in fact it did nothing to eradicate previous inflation nor did it do anything to resolve the proximate source of inflation which was the budget deficit. The intractable problem of balancing the budget, which would only be realised between 1926-29, was to a significant degree a political problem. The ultimate explanation for France's inter-war financial instability was the inability of the political class to form a long lasting coalition able and willing to balance the budget, though, from the late 1930s on budget deficits became largely inevitable as a result of the belated build-up of military expenditure.

Of profound psychological importance to French policy-makers was the notion that sterling's devaluation was forced upon the UK authorities and that it represented a once and for all adjustment to post-war realities. France on the other hand had already devalued, the Franc Poincaré having lost 80% of the *Germinal* franc's gold value. It was felt that the national sacrifice which the war had imposed had already been paid. Throughout one must always distinguish the character and nature of France as it perceived itself and indeed was, viz., a nation of small, often rural, savers. Even the communists spoke out in favour of the *petits rentiers*, the owners of the French *rentes* (consols.) were not exclusively dissolute

[10] cf., Reynaud's distinction between a devaluation *à froid* which would be prepared and accompanied by measures to deal with the fiscal deficit, and a devaluation *à chaud* which would be forced on government.

Proustian figures.

The UK had returned to gold less for ethical reasons, but rather because the sterling/gold standard had put the UK at the centre of the world trade system, or was perceived as having done so. The radicals and radical-socialists found their electoral support amongst the small rural proprietors and though the radicals supported the left they remained, on the whole, financially orthodox,[11] in particular in the Senate where the radicals formed the largest group.[12] J.Caillaux was an exemplar of the type and from 1932 chaired the Senate Finance Committee. This helps explain some of the difficulties which any coalition of parties of the left, as Goguel calls them the parties of "*mouvement*" had in producing a coherent economic programme. It was also felt, on moral grounds, that the 1932 conversion of the *rentes* from 5-6% to 4.5%, had succeeded on the tacit assumption that the Poincaré franc's gold parity would remain inviolable. Devaluation would mean moral obloquy for any government which debased the currency further. The question of the Auriol bonds and the moral default of the *Front Populaire* was to loom large in the opposition critique of devaluation in September 1936.

From a domestic perspective the objections to further devaluation were ethical, viz., the moral obligation to stick to one's contractual obligations which are at the root of the liberal economic system and are the mainstay of the politics of freedom. The historical sacrifice made by the *rentiers* class acted as a further constraint.

As we will see the economic argument against devaluation formed a consistent and logical whole. Commentators argued that a devaluation would be followed by a rise in prices because, unlike the US and the UK imports were not invoiced in francs and therefore given the law of one price the price of imported goods would rise *pari passu* with the rate of currency depreciation. Though it was acknowledged that in the case of wheat this would not be so as domestic wheat prices had been protected and a scheme to set up a minimal price had been tried,- at first it was not very successful as the government was not willing to expend any funds on it (sugar beet prices were also maintained at an artificially high level). It was also argued that workers would be unwilling to contemplate a fall in their real wages, i.e., that they would not confuse nominal with real wages. However, Sauvy has argued that

[11] see Goguel (1946).

[12] see Schlesinger (1974).

labour did confuse real and nominal variables, in part because of poor statistical indicators, and he points to wage demands on the part of government employees in 1935 when in fact their real wages had risen (though of course this is viewed *ex-post* using price indices available after the fact, the important point remains the public's contemporary perception).[13] The communist party, in particular, vehemently opposed devaluation for this reason.[14] The communists would press for a wage indexation clause when it became apparent that devaluation was inevitable. This demand was strongly resisted by the parties of the centre-right and by the radicals and radical-socialists.[15] One political commentator quipped that the communists were opposed to devaluation, as failure to devalue would lead to the collapse of French capitalism.

One of the arguments against devaluation was that as a result of upward pressure on wages, salaries and prices, civil servants would demand pay increases which would have an immediate incidence on the budget deficit, even if one took account of the more buoyant revenue as a result of an expected short-lived increase in economic activity following a devaluation. The more sophisticated orthodox commentators did recognise such short-term positive effects, viz., increased budgetary revenue, flowing from a devaluation. The problem of financing the deficit would be made more acute as state bankruptcy would lead to a run-off of short-term Treasury paper as investors failed to renew bills maturing and this would leave the government with but one recourse, viz., advances from the Bank of France. This would be made that much easier as devaluation would have realised large book-keeping profits accruing to the Bank of France which would go to extinguish the Treasury's debt to the Bank. Allowing the whole process to begin anew, the advances would increase the money supply, lead to a flight into real values, a flight from the currency, a forward discount on the franc, further expectations of depreciation and resulting mark-up of internal prices, increased wage pressure and social strife.

In addition it was argued that any unilateral depreciation of the currency would have led to retaliation and it must be remembered that sterling was on a "dirty float" managed by the Exchange Equalisation Account and that President Roosevelt, who was by then

[13] see Sauvy (1984).

[14] cf., speeches by M.Thorez and J.Duclos.

[15] see chapter nine of this thesis.

considered highly unreliable in financial matters, no less by the British than the French still had the facility to lower the gold value of the dollar from the existing 59% of its former parity to 50% (under the Agricultural Adjustment Act). A unilateral depreciation could therefore lead to competitive devaluation and raising of quotas and tariffs, as the French had done when sterling went off gold.

The orthodox policy prescription was therefore that, the budget be balanced,[16] preferably by reducing expenditure, certainly, the centre-right parties preferred this option,[17] whilst the communists would have favoured reductions in military spending and steeply rising income tax schedules as well as a wealth tax. The radicals favoured direct taxation, as opposed to recourse to indirect taxation which was the preferred option of the right. The radicals were also divided on the question of a capital levy. Of course, the problem with any policy of expenditure reduction was that much of current expenditure was incompressible due to the burden of the past, e.g., financing the outstanding stock of debt, and war pensions. And as far as revenue raising was concerned there was no consensus, and higher taxes, particularly on wealth, would lead to capital flight. Higher taxes would also burden business and would only be passed on in additional costs.[18] The right would have argued that a wealth tax and its assessment constituted an unwarranted intrusion into the individuals' private affairs and such a policy would have been considered dictatorial. This was one reason the radical-socialists, who were wedded to individualism vetoed any idea of exchange control which the Popular Front might have had. This also explains why the radical Herriot government of 1924 abandoned the *bordereau de coupon* which had to be held by a financial institution for the *carnet de coupon* held by the individual. The SFIO considered exchange

[16] "*Nous estimions, et nous pensons encore, que des finances en parfait état étaient la condition de la prosperité des affaires publiques et de la reprise de la vie économique qui était notre principal souci.*" Germain-Martin (1936) p.103.

[17] Quoting Germain-Martin in defence of his policies as Finance Minister under Doumergue, "*Dans ces conditions, toutes nouvelle augmentations du taux des impôts devait se trouver fatalement à la charge du consommateur; elle avait pour conséquence de réduire d'autant le pouvoir d'achat du public et l'on peut donc affirmer que la politique des économies, loin de diminuer le pouvoir d'achat de la Nation, l'a augmenté, puisqu'il a permis de diminuer les impôts anciens, d'en éviter de nouveaux.*" Germain-Martin (1936) pp.255-256.

[18] Quoting Germain-Martin (1936) on the period 1931-32 and the crowding-out effects of a higher fiscal burden as well as the political difficulty of increasing taxes, "*De plus, le poids des impôts était tellement insupportable que toute aggravation aurait suscité les problèmes politiques les plus sérieux. L'impôt, toujours accru, n'a été que trop une cause de gène pour les entreprises.*" p.73.

controls, but then shelved the idea.

Kaleçki (1938) attributed the failure of the Popular Front government to its refusal to introduce exchange controls - Bank of France Governor de Labeyrie apparently favoured exchange controls, but would be dismissed by the incoming Chautemps government. Blum in 1938 did propose exchange controls when seeking decree-making financial powers, however his government fell before the Senate. The Popular Front government was also fearful of alienating the anglo-saxon democracies and cutting itself off should it introduce exchange controls.[19]

Though commentators were aware that in a cyclical downturn revenues tend to fall off they remained wedded to the idea of a balanced budget. It is this failure to understand the cumulative perversity of deflationary policies which is crucial to understanding policy failure in the 1930s. Very few voices spoke out against this policy. The most prominent outspoken critic was Paul Reynaud, less well known public figures were Raymond Patenôtre, Henri Clerc, Georges Boris and Bertrand de Jouvenel. E.Daladier flirted for a while (1934) with the idea of a steadily depreciating currency, "*la monnaie fondante*."[20]

R.Patenôtre was owner and editor of Le Petit Journal; H.Clerc a radical deputy; G.Boris was editor of La Lumière, a newspaper with radical sympathies; and B.de Jouvenel was economics columnist for La République, a radical newspaper.[21] Mouré states that de Jouvenel was influenced by G.Boris.[22]

P.-E.Flandin (November 1934 to May 1935), of the *Alliance Démocratique*, did abandon deflation and was willing to accept a short-term deficit, hoping that in the wake of economic recovery government revenue would rise.[23] However, his mildly reflationary policy stance was short-lived and he had to make a "U turn". His government fell when denied decree-making powers in the financial field, which were a precondition of assistance from the Bank of France. He was succeeded, after a short-lived Bouisson government, by

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[19] see Lefranc (1974).

[20] see Silvio Gessel and the Woergl experiment in Austria.

[21] Biographical details from Mouré (1991).

[22] Mouré (1991) p.43.

[23] Apparently Flandin had been influenced by Roosevelt's New Deal programme on a visit to the US and Canada.

Laval (June 1935 to January 1936) who inaugurated a policy of deflation *à outrance*.

In 1929 Tardieu, also a politician of the right, proposed a public works programme which would in part use the proceeds of revenue surpluses (the so-called "*Trésor Chéron*"). However, public works only materialised in an adulterated form in the guise of the 1932 Marquet plan.[24]

Tax reductions and government "*largesse*" such as the introduction of war pensions (later reduced by decree and restored as part of the devaluation package in 1936) during the period of fiscal surpluses was later blamed for the deficits, i.e., that these had structurally undermined the budget. Germain-Martin was of the opinion that a good budget was one just in balance as any surpluses would lead to demands for expenditure in favour of interest groups which would be hard to reverse.[25]

The socialists (their mouth-piece was, *Le Populaire*) were the only prominent party to reject deflation and the orthodox economic view, though their financial perspective remained essentially orthodox. In fact it might be said that of all the parliamentary groups and parties the socialists were the only ones who had an economic perspective as opposed to the dominant *laissez-faire* purely "financial" orthodoxy, which was a natural product of the liberal world-view. The SFIO remained a Marxist or, rather, social-democratic party in the pre-Bad Godesberg sense, i.e., Marxist, but not Marxist-Leninist. Its class-based analysis probably contributed in generating its aggregative economic perspective, as opposed to the essentially atomistic approach espoused by the "*bourgeois*" parties. The resulting analysis was at least an attempt at understanding, from an economic perspective, the sources of the domestic economic crisis.

From a wide-reading of press articles and secondary bibliographic material, one's first impression is of some muddle in the analysis. However, one can discern an underlying model which in its essence is under-consumptionist.[26] The analysis, formulated in the requisite neo-Hegelian dialectic, was based on the supposed intrinsic contradiction between the increased productivity of the means of production and the inability to absorb the surplus

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[24] see Jackson (1985).

[25] Quoting Germain-Martin (1936), "*...je prétends qu'un bon budget côtoie le déficit afin d'imposer le minimum d'efforts et de sacrifices aux contribuables tout en incitant à la réserve dans la dépense.*" p.258.

[26] see Bleaney (1976).

of material goods thus created, due to a heavily skewed distribution of income and wealth. The answer was to increase the purchasing power of the working masses in order to absorb this surplus. The CGT union also pressed for a 40hr. week in order to spread work. Similar ideas based on theories of over-production were to be found in wider political circles and were instrumental in encouraging cartelisation, e.g., Flandin's policy of encouraging cartelisation in highly concentrated industries.[27] It is obvious, however, that there was a degree of confusion in Blum's thinking. When he denounced deflation and devaluation he argued that his consumption-led reflationary programme would not be inflationary as increased production would not raise costs as such a high proportion of costs were fixed. As a result higher output would dilute fixed costs per unit of output, and leave unit costs unchanged. However, if the crisis was caused by relative over-supply, any increased output would be expected to worsen the situation and call for an ever greater distribution of income from capital to labour. Blum argued that economic recovery would bring in its wake increased government revenue,- at least he was working in the right direction, viz., the idea of a cyclical budgetary and macro-economic stance.

One should note that over-production theories were the obverse of under-consumption theories. The former appealed to the right and legitimised a policy of tight money and fiscal rectitude, a sort of Masoch-economics; whilst under-consumption theories found a ready audience on the left as they legitimised a policy of income redistribution towards the working class. One should note, as Mouré (1991) points out, that the dominant view which ascribed the depression to the impact of over-production estimated that this largely originated from abroad, particularly the collapse in commodity prices, as such there was little that policy-makers could do except ensure that proper domestic credit conditions prevailed, viz., a balanced budget.

It is sometimes averred that Blum was inspired by the "New Deal", however Jackson (1985) has argued that Blum's policies were already fully worked-out by 1932. It is also certainly the case that the socialist programme formed a much more articulated theoretical whole (the Marxist legacy dictated a scientific understanding of economic phenomena) than Roosevelt's very pragmatic and desultory activism. Nevertheless, Blum cannot have failed to have been influenced by the "New Deal" programme which had already been in existence

[27] see Jackson (1985).

for three years by the time Blum first assumed office.

Were Blum's policies proto-Keynesian? Keynes' General Theory did not appear until 1936 and was, as yet, untranslated. It is generally argued that his ideas had not yet spread widely enough to have had much impact. However, Blum's aborted 1938 economic programme is said to have been inspired by Keynesian thinking.

Could one argue though that Blum's policies were keynesian all the same? I think not. First of all Keynes was more concerned with stimulating output through increased investment and public works expenditure, whilst the SFIO's economic programme falls into a distinct under-consumptionist economic tradition of the left, viz., absorbing/realising the surplus or excess output given the relative distribution of income and consumption demand. Nonetheless, it cannot be denied that there are affinities.[28] Keynes' programme is of course more geared to the possibilities offered in a totalitarian state, as he himself recognised in the preface to the German edition of the General Theory. In that edition Keynes argued that his policies had the best chance of success in Germany,- he was right!

Nevertheless, the predominant and orthodox view, which was confined to a very narrow fiscal outlook, was that by balancing the budget, interest rates would fall, the *rentes* (government debt) would rise which would make it easier for the government to consolidate the debt, and therefore allow the authorities to resume control over the money market,- for in the past any financial panic had led to a run-off of outstanding Treasury bills and subsequent monetisation of the bills falling due. A lower deficit would stem crowding-out of the private sector (the "Treasury view") and lower interest rates would stimulate investment led recovery.[29]

A more refined view, expressed by Senator Gardey, for example, was that devaluation

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[28] One should note however that Blum's analysis actually more closely resembles the Mises/Hayek theory of the trade cycle which also recognises a deficiency of consumption demand to explain surplus output. In the "Austrian" theory, though, the causal role is played by policy-makers artificially reducing the rate of interest below the level which reflects the time-preference/consumption demand of economic agents, rather than the putative internal contradiction in the Marxist model between the means of production and the distribution of income. In the UK James Strachey, Oswald Mosley's sometime Parliamentary Private Secretary, recognised the affinity which existed between Hayek's theory of the trade cycle and the economic conditions which then prevailed (see Winch, 1969; and Strachey, 1935).

[29] Quoting Hawtrey, "The private demands on the capital market for internal investment would be diminished by the amount of the Government's demands." From The Art of Central Banking, p.435. It was also thought that Government borrowing would raise interest rates and make debt conversion more difficult. As we can see this was a view shared by Germain-Martin.

would be pointless without a clear fiscal programme to balance the budget and an international currency agreement. In many ways the orthodox case was justified and certainly the devaluation *à chaud* undertaken by the Popular Front government and the subsequent continued financial debacle with the two subsequent devaluations of the French franc, in 1937 and 1938, as the budget deficit continued to widen indicate that devaluation on its own did not constitute a policy,[30] though this deterioration in the overall financial situation was to a great extent due to increased military expenditure. Nevertheless, subsequent currency experience did, in many ways, vindicate the view of the financially orthodox. If a devaluation were to take place it would have to be *à froid*, as Reynaud had argued, and be part of a coherent package. Some, e.g., the younger radicals, argued that it should include a greater degree of planning[31] or alternatively, as advocated by Reynaud, liberalisation and particularly loosening up of labour supply rigidities which the 40 hour week had caused by creating bottlenecks in the economy.[32] The latter course was that adopted by Reynaud when Finance Minister in 1938.

Today, now that simplistic Keynesian nostra have been buried it is easier to understand the grave reluctance felt by policy-makers in embarking on a devaluationist course. Arguments adduced then remind one of those propounded by supporters of EMU today who argue that government has little, if no control over real variables in the long run, therefore devaluation is self-defeating.[33] However, what is most lacking in inter-war currency analysis is the lack of a macro-economic view of the economy and the cumulative depressive effects of deflation *à outrance*, which actually led to a rise in real wages, at least those of civil servants,[34] and an increase in the real debt burden.[35] And even if one were to accept the putative policy ineffectiveness thesis no one would deny the ability of the authorities to inflate nominal variables, which is exactly what Hawtrey supported in order

[30] cf., Reynaud's *critique* of the Popular Front's devaluation bill in chapter nine.

[31] see Jackson (1985).

[32] see Marjolin (1938).

[33] q.v., S.Brittan - deputy editor of the Financial Times. These views are broadly those of the global monetarist school. For an early development of these ideas see Hayek (1937).

[34] see Sauvy (1984).

[35] see Fisher (1933).

to bring a stop to the perverse process whereby nominal variables were being chased down in a deflationary cycle.

Paradoxically, as many of the more rigorous commentators pointed out an obstinate and tenacious adherence to the Poincaré gold parity and belief in the free market were leading governments wedded to free market principles in quite an opposite direction in practice, that is agricultural protection, viz., attempts at shoring up the price of wheat,- in this regard the only effect of the early measures to set a minimum price for wheat, which ran during 1934 to 1935, was not to favour the producers, but intermediaries and to raise the retail price of bread as the price was based on the minimum price of wheat and as Ricardo would have argued this added to downward wage rigidity. Some, such as P.Reynaud, were to point out that the purchasing power of gold itself was not stable and that therefore strict adherence to the gold parity did not signify a constant purchasing power for the currency. Attempts to broach the question of stabilising the purchasing power of gold at the Bruxelles conference in 1920 and the Genoa conference in 1922 came to naught. Irving Fisher was to become a strongly committed exponent of a dollar endowed with a stable purchasing power. The French would have called this "*la monnaie dirigée.*" Roosevelt's 1933 "bombshell"[36] confirmed that he had become an adherent of that doctrine.

Quotas, in particular, but also tariffs, prevented the domestic price level from adjusting and so falsified the automatic adjustment mechanism which economists ascribed to the market. However, politicians had to consider their local constituencies in an economy which remained rural. Other orthodox commentators argued that the depression was not due to monetary factors, but to an imbalance between low commodity prices, which reduced the purchasing power of exporting countries and hence their demand for industrial products whose output had increased significantly due to technological change, though this view was shared by many, such as Reynaud and in the UK Hawtrey emphasised the disparity between wholesale and retail prices. However, Reynaud, and Hawtrey in the UK, had come to realise that it was impossible to deflate the nominal price level (retail prices), to the extent required. Devaluation would raise prices, stimulate economic activity and fiscal revenue. It would also tend to raise wholesale prices in line with retail prices. One should add that any reduction in real wages which might be thought to result could be offset by the boost to demand and

[36] see chapter six of this thesis.

income following a relaxation of credit and monetary policy.

The orthodox financial view failed to grasp that deflation of the magnitude required really amounted to the tail wagging the dog and that it was essentially perverse. Laval's logically consistent attempt at reducing expenditure, prices, coupons payments, etc., by 10% all round, and which marked the end of the deflationary experience was a particularly outstanding exemplar of this. The perverse effect of deflationary policy resided in its impact on: profits, sales, employment, and the general negative effect it had on expectations. This was compounded by the deflationary forces transmitted across the exchanges (due to the fixed gold parity), and the perverse deflationary dynamic caused by nominal variables chasing each other in an ever descending cycle.[37] This was exacerbated by attempts at balancing the budget which negated any built-in contra-cyclical stabilisers.[38]

Falling demand and increased real debt and transfer payments made the revenue balancing exercise that much harder to meet, with consequent renewed deflationary bouts and a further widening of the budget deficit. This was on top of periodic ministerial crises and financial runs. The nature of the parliamentary system and the refusal of the legislative to act responsibly meant that during periods of extreme crisis executive power was abandoned by means of grant of decree-making powers to the executive. These were then not renewed and were followed by a further reversal of fortune for the currency and renewed political instability.

One is left with the impression that policy-makers were left floundering from one initiative to another, making policy on the hoof. There were a few exceptions. Poincaré being the most notable exemplar, and the only one to be successful. Some other few, invested with temporary decree-making powers, made attempts to deal with the crisis by means of renewed bouts of deflationary policy. In the latter category we find Laval, who pushed deflation to its logical extreme, and failed. This left the way open for Blum's alternative policy characterised by the slogan, "*ni dévaluation, ni déflation.*"

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[37] see chapter two - comment on McCloskey & Zecher.

[38] Middleton (1985) has pointed out that with a strict balanced budget rule, the larger the fiscal stabilisers the tighter and more perverse budgetary policy has to be.

CHAPTER 6

THE GOLD BLOC: A DEFENSIVE CURRENCY PACT

The aim of this chapter is to demonstrate the defensive nature of the Gold Bloc which was established following the resounding failure of the June 1933 World Economic Conference to reach an agreement on international currency stabilisation. It also aims to analyze the workings of the Gold Bloc and its essential limitations. These help explain why in many ways the Gold Bloc was but a holding operation. It will also explore the reasons for which economic co-operation within the Bloc never got off the ground and the extent to which the MFN (most-favoured-nation) clause constituted an impediment to intra-Bloc trade liberalisation.

Before we treat the World Economic Conference we must recall that the Ottawa conference, held in 1932, though successful as a currency and preferential trade bloc, set an unhelpful precedent for international co-operation ahead of the World Economic Conference.

Patricia Clavin (1991) emphasises this and argues that the World Economic Conference constituted a failure of British financial and economic leadership. Her case rests on the argument that British unwillingness to discuss Imperial Preference and its token payment to the US on its war debt liability in June sent the wrong signals to the US. This increased congressional opposition to any concessions on war debts. Clavin adds that MacDonald's request in his inaugural address to the conference, which had not been scripted in the earlier press release, that war debts be included in the agenda further conspired to sour relations.

The US had, of course, always refused to put the question on the agenda. However, given that the international payments system had been severely impaired by the whole tangle of war related debts and reparations, and the possibility that the Lausanne agreement might unravel, it seems perfectly understandable that MacDonald, as Chairman and host, should attempt to bounce that subject on to the agenda.

Similarly Empire Preference was not something suddenly sprung on the Conference, it had been included in the 1931 Tory party general election manifesto.[1] Whilst President Roosevelt's utterly cavalier remarks concerning exchange rates and the arbitrary way in which he set the dollar price of gold could not have been more unsettling,- at least from an international perspective. As we will see research has made it plain that the US delegation had no idea what the President's policies might be, presumably because neither did he. The US delegation was constantly undermined in its negotiating stance by Roosevelt. I would therefore lean toward the traditional interpretation viz., that Roosevelt's policies though "magnificently right" undermined the Conference and could have been couched in more diplomatic terms. However, our opinion is that no satisfactory outcome, in terms of an international agreement, was by then possible, nor perhaps even desirable short of a general reflation on gold.

Nonetheless the British attitude ahead of the Conference and adoption of the Empire Preference system should have acted as a clear pointer to French delegates to the World Economic Conference that the UK was desperately concerned to act in favour of raising the general price level and, in particular, commodity prices. As we will see the consensus of opinion amongst British economists, both inside and outside government, was that the depression was due to a fall in prices.[2] This had raised real debt burdens and acted as a drag on recovery. British policy-makers were also of the opinion that early post-war experience had demonstrated that nominal wage deflation, in a democracy, had certain limits.

The French attributed the depression to easy credit and over-production, which in turn was responsible for depressed commodity prices. This had resulted in a fall in demand for manufactured products. The solution lay, therefore, in a return of prices (of manufactureds) and costs (principally labour costs) to lower levels which would bring supply into balance with post-war demand conditions by deflating the nominal/retail price level into line with wholesale prices. France's post-war experience with inflation and currency depreciation made her particularly wary of any artificial schemes aimed at tampering with the working of the gold standard. As we will see historical experience had a very significant impact on subsequent policy decisions. The British view was equally that a better balance should be brought between costs and prices. However, as the British experience with post-war

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[1] cf., Eichengreen "Sterling and the tariff," (1931).

[2] see chapter seven on the devaluation debate.

deflation had shown its practical limits analysts such as Hawtrey came to the view that raising the wholesale price level (flex prices) in line with fixed costs, e.g., labour, was less intractable than attempting to deflate the absolute price level which only resulted in raising real fix prices and lowering output and that attempting to do so by maintaining a tight budgetary stance was self-defeating. It is Eichengreen's (1992) central thesis that this lack of a common conceptual framework largely explains the failure of international cooperation during the inter-war years. The difference in opinion though lay more in the policies which should be adopted to rectify the widely recognised imbalance between costs and prices, namely deflation or inflation.

THE WORLD ECONOMIC CONFERENCE:

The decision to convene a world economic conference was adopted at Lausanne in July 1932.[3] The Conference was preceded by sets of preparatory bilateral meetings. These were the Herriot-Roosevelt conversations, as they are referred to in French official documents, and the MacDonald-Roosevelt discussions.[4] Already before the Conference began Roosevelt was taking maverick decisions, and it was as Herriot and MacDonald were sailing the Atlantic that the President chose to take the dollar off gold, despite having enormous gold reserves. Of course this decision was taken for domestic reasons,[5] but from a French perspective it would have been considered ill-judged particularly ahead of the Conference. Roosevelt's ensuing policy which aimed at injecting money into the monetary system by progressively increasing the purchase price of gold and silver was certain to further unsettle the financially orthodox. For a time Roosevelt appears to have drifted into a form of inflationary bimetallism. Strohl (1939) argued that the US position and its subsequent behaviour at the World Economic Conference was to strengthen the hands of those French policy-makers opposed to devaluation.[6]

Roosevelt had suspended gold exports in March 1933 following the banking crisis and

[3] see Clavin (1991) p.491.

[4] for *communiqués* see Pasvolsky (1933).

[5] see Eichengreen Golden Fetters.

[6] see Strohl (1939).

on April 18th he halted all exchange support operations and allowed the dollar to depreciate. Clarke (1973) has suggested that Roosevelt's decision was adopted to forestall pressure from Congress for inflationary and non-discretionary measures.[7] Clarke also suggests that Roosevelt devalued as MacDonald was sailing to meet him to increase his leverage. As a result sterling appreciated rapidly and we will see that, whilst in April the British government would consider $3.50 as a maximum stabilisation parity for sterling[8] by June the proposed stabilisation accord considered $4 as the basis for stabilisation.[9] As we will see in chapter nine, by autumn 1936, within the framework of negotiations concerning a Tripartite stabilisation agreement, the US would be pressing for a rate of $5.[10]

It is perhaps interesting to note some of the domestic background to Roosevelt's decision to unilaterally devalue. This has recently been explored by Eichengreen (Golden Fetters). The World Economic Conference had originally been convened whilst Hoover was President, who favoured a British return to gold.[11] However, he lost the election and the four month inter-regnum before Roosevelt's inauguration added uncertainty to the existing crisis. Roosevelt inherited a full blown banking crisis. Eichengreen argues that the catalyst for the banking crisis in March was the fear that Roosevelt might devalue.[12] Federal reserves were dropping making accommodation the harder, and fear of devaluation led to further gold losses.[13] Any accommodation would therefore become self-defeating and was offset by internal and external drains as funds were shifted from deposits into currency and gold. On 6th March Roosevelt was forced to declare a bank holiday.[14] However, confidence returned when Roosevelt failed to devalue and the liquidation of deposits came

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[7] see also Eichengreen Golden Fetters..

[8] see Sayers (1976).

[9] see Mouré (1991).

[10] see Clarke (1977).

[11] see Eichengreen, Golden Fetters, p.321.

[12] op.cit., p.326.

[13] Eichengreen, op.cit., pp.323-324.

[14] op.cit., p.329.

to a halt.[15] The stronger dollar lasted till mid-April when the market "got wind" of a change of mind on Roosevelt's part in favour of devaluation.[16] Eichengreen argues that he had been convinced that to restore prosperity the price level had to be raised. And in Congress silver interests and farmers began to form a reflationary bloc. To contain the Senate reflationists who supported unlimited silver monetisation the President agreed to the Thomas Amendment,[17] which allowed him to contain reflationary demands. The Amendment allowed the President to mandate $3bn. of open-market policies or of greenback sales, should the Fed. refuse.[18] Under the Amendment the President also enjoyed the faculty to reduce the gold content of the dollar, to 50% of its former parity, and could authorize the coinage of silver. Eichengreen quotes R.Moley (Roosevelt's leading advisor) who pointed out that the President had not yet formulated an economic plan, hence the gold embargo which was opposed by the Fed.. However, as Eichengreen states the decision to allow the dollar to depreciate became inevitable once the Thomas Amendment was passed.

The preparatory bilateral meetings, held ahead of the London Conference, between the US and the UK and France and the UK, issued in *communiqués*. These are significant because they illustrate the gulf which divided British and American from French analyses of the causes of the depression and the prescriptive policy action needed. The MacDonald-Roosevelt *communiqué* makes clear their belief that central to a recovery in economic activity was a rise in commodity prices and that both economic and monetary action were needed to this effect.[19] The *communiqué* goes on to commend a policy aimed at reducing impediments to trade, as well as concerted central bank policy to increase credit and ensure its injection into circulation.[20] It is clear from the foregoing that from an orthodox economic perspective this statement indicated a radical departure from 19th century text-book economic

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[15] op.cit., p.330.

[16] op.cit., p.331.

[17] op.cit., p.331. One should note that the Thomas Amendment was attached to the Agricultural Adjustment Act. The aim being to raise agricultural prices by depreciating the currency.

[18] op.cit., pp.331-332.

[19] see annex to Strohl (1939) which has appended to it the French version of both *communiqués*. Pasvolsky (1933) includes the English versions.

[20] Strohl (1939) p.246.

liberalism, which French policy-makers still remained wedded to. The MacDonald/Roosevelt *communiqué* considered stabilisation as the crowning of the process of economic recovery. It argued that any international currency standard would have to avoid the pitfalls of falling prices. It is clear that what we have here is one of the first political declarations of intent in favour of a policy which we have come to know as Chicago monetarism. This policy shift was also a reflection of the growth of mass participatory democracy and increased labour strength, reflected in a labour market which was characterised to a greater extent by fix-nominal wage prices.[21] Of importance in changing the attitude of government was increased responsibility for economic performance and particularly employment. This was already manifest after the First World War in the UK, where deflation was postponed for a while in order to make the labour absorption process smoother as demobilisation proceeded.[22]

The Herriot-Roosevelt *communiqué* showed no agreement on any of these issues and merely catalogued them as topics for discussion relevant to the state of the world economy. It was already clear that there would be little meeting of minds in London.

Mouré (1991) and Strohl (1939) have argued that French policy-makers were, from 1931 onwards, wary of possible attempts on the part of the UK and US to dictate some form of gold redistribution as part of any general international negotiations. One should note that in January 1933, at a preparatory meeting ahead of the World Economic Conference, "the British demanded as a condition of returning to gold, that France modify its central bank regulations in order to encourage a more even international distribution of gold. The British proposed that cover ratios be reduced and expansionary open market operations be legalized."[23] Sir Frederick Phillips recognised that there was little prospect of agreement to such a proposal. Chapters two and ten make it plain that these conditions would have been considered totally anathema, and would have destabilized the franc as the public would have anticipated a return to the financial uncertainty which had characterized the pre-stabilization years. Mouré has argued that this sort of difference of views may explain why it took until 1933 to convene an international Conference.

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[21] Similarly in the 1970s the collapse of the putative Phillips curve set of trade-offs was to reflect, in the UK at least, increased union militancy and greater awareness of real variables.

[22] see Howson (1974).

[23] Eichengreen, Golden Fetters, p.334.

However, by 1933 the situation had changed. Lausanne had ended German reparations and the UK had less interest in gold redistribution now that it was off gold.[24] Though one should note that war debts were officially off the agenda on US insistence. US opinion was opposed to a write-off.[25]

At the time proposed international monetary reforms that were mooted included the issue by the Bank of International Settlements of gold certificates, which presumably could only take place if national gold reserves were transferred to the BIS. If this had occurred it would have been a forerunner of the original SDR. Other variants included a common fund managed by the BIS to assist countries in restoring the gold standard and lift exchange restrictions.[26] This may have originated from Quesnay.[27] However, according to Mouré, the British considered this insignificant. International public works were another scheme thought to be considered.[28] This, according to Strohl implicitly, implied the redistribution of gold reserves.

It is Strohl's thesis that the French government of the time, and in particular the French Finance Minister, Bonnet,[29] was wavering on what course to adopt ahead of the London Conference, but that subsequent US intransigence increasingly stiffened France's resolve to abide by financial orthodoxy. The French government was intent on securing some form of commitment, however loose, in favour of currency stability. This does demonstrate that France was willing to be flexible. However, the bottom-line still remained that France was committed, for historical and political reasons, to the Poincaré franc. And Strohl has perhaps exaggerated the extent to which the French government was wavering.

Clarke has suggested (1973) that in preparatory meetings held in the winter of 1932-33 the US was closer to France on the monetary issue and on the idea that the UK should

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[24] see Mouré (1991) pp.80-81.

[25] see Eichengreen, Golden Fetters.

[26] see Mouré (1991) footnote 11.

[27] For Quesnay's own proposals ahead of the Conference see Mouré (1991) p.101.

[28] Strohl (1939) p.198.

[29] Strohl (1939) p.202.

return to gold,[30] whilst the UK premised any stabilisation on a rise in prices. Clarke suggests that in the last few weeks of Hoover's administration a deal might have been possible, suggesting that the UK might have been willing to stabilise. However, given its constant reluctance to enter into any exchange rate commitment it is hard to believe that the UK would have accepted to peg its exchange rate. An added difficulty with the Conference was that Roosevelt had been unwilling to co-operate with the outgoing Hoover administration in preparing the Conference, which meant that there was a lack of continuity.[31]

Mouré (1991) alludes to an episode between Bonnet and Neville Chamberlain (Chancellor of the Exchequer), at a preparatory meeting held ahead of the World Economic Conference. The meeting took place on 17th March in London. Bonnet, in his memoirs,[32] states that when Britain refused to issue a joint statement on currency stabilization at the World Economic Conference, Bonnet was disappointed as he had come away from the preliminary London meeting with the distinct impression that the UK and France were largely in agreement over the issue. As we will see, again and again, French policy-makers failed to appreciate how unpalatable fixed exchange rates had become in the UK.

Strohl argued that France gradually drifted into its Gold Bloc policy and that it was not the product of some well-articulated plan.[33] However, this is somewhat at odds with Bussière's thesis, which studies the Gold Bloc from a Belgian perspective. Bussière has argued that, following the failure of the Ouchy trade accord and Great Britain's move towards protectionism in September 1932 after the Ottawa agreements, Belgium tried to promote the idea of some form of customs union. This would bring together the Benelux, Germany and France. Bussière (1988) has argued that from 1932 such a policy objective became a central tenet of Belgium's international economic policy.[34] Apparently British refusal to adhere to the Ouchy accords, which effectively scuppered this initiative, helped

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[30] Clarke (1973) pp.26-27.

[31] see Clavin (1991).

[32] cf., Mouré (1991) p.92, footnote 48.

[33] Quoting Strohl (1939), *"C'est donc bien sous la pression de circonstances particulières, et non à la suite d'un plan mûrement réfléchi et lentement élaboré que la délégation française s'est vue amenée à s'ériger en défenseur intransigeant de l'orthodoxie monétaire."* (p.204).

[34] Bussière (1988) p.692.

foster the idea of a rapprochement between France and Belgium.[35]

Bussière, therefore, concludes that as the London Economic Conference opened the option of creating an economic union out of a monetary agreement was already available as a possible outcome for France and her smaller neighbours.[36] However, it may well be that Bussière, as a result of focusing on the Gold Bloc from a Belgian perspective, overestimated the importance of Belgium in French calculations. It is apparent that Bonnet, the chief French negotiator, chose to create the Gold Bloc when there appeared no prospect of securing an international agreement on stabilisation and as a defensive pact to stem the run on the Dutch guilder and Swiss franc which could well have spread and endangered all the remaining gold currencies. This is borne out in the minutes of the *Conseil de Régence* of the Bank of France held on 29 June 1933, in which the Governor reported that Bonnet was doing his best to get the British to issue a joint declaration in favour of currency stability. Nevertheless, one should bear in mind the paper (*vide infra*) prepared by the *Directeur politique-adjoint* at the Foreign Ministry in which he argued in favour of an economic and political anschluss with Belgium, which tends to take Bussière's argument even further.

An internal Finance Ministry memorandum provides a useful French perspective on the course of negotiations prior to, and at, the London World Economic Conference. The paper is entitled, "*Conditions dans lesquelles la Délégation Française a pris position à Londres sur les questions monétaires,*" and dated 30/9/33.[37] According to this document the US Delegation, at the preliminary talks held in Washington on 25-26th April, confirmed that the US's ultimate objective remained the re-establishment (*restauration*) of currencies. And, were it to prove impossible to stabilise the dollar at a lasting rate in the immediate future, the US government might be favourable to the immediate creation of an exchange stabilisation fund. The parities would have to be determined and the rates of the dollar and sterling would be up for subsequent revision. The paper stated that the President concurred. The French delegation sought further negotiating instructions following the US statement.

The French delegation was instructed not to adopt a negative attitude, but to be wary as this came just after the US had unilaterally abandoned gold. The French delegates were

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[35] Bussière (1988) p.697.

[36] Bussière (1988) p.700.

[37] source: M.F., 30/9/33, B 32 323.

told by Bonnet to discuss these proposals, though they were sceptical as to the benefits of exchange stabilisation funds and the principles underlying such methods. However, the French remained willing to examine the proposals from a technical perspective, on the understanding that this in no way bound the French government.

According to this memorandum the US delegation had waited for the French reply before taking the matter more in-depth with the British. The French delegates had remained in touch with the British on these questions. Apparently the British experts were particularly keen that the US use its resources to defend the dollar. The memorandum referred to an article in the New York Times confirming these negotiations, despite the fact that they were meant to be secret. The article which appeared on 29th April stated that MacDonald, Herriot and Roosevelt had studied a possible currency stabilisation agreement ahead of the London Conference.

Bussière alleges that Paris refused to agree to a joint currency stabilisation fund and to a currency truce. However, from a French perspective a joint stabilisation fund might suggest that its gold reserves might be used to prop up other currencies, a sort of back-door redistribution of gold reserves, and reluctance to agree to a tariff truce was certainly understandable given the earlier unilateral US devaluation which might invite the use of compensatory tariffs in order to protect the French economy from importing its deflationary effects.[38]

At a meeting held at the Ministry of Finance on 12th May which was attended by Moret, Tannery and Rist it was concluded that nothing would come of the World Economic Conference unless currency stability was agreed, and that this position should be made known to both the UK and US governments so that France could disown responsibility should the Conference fail.[39] At the same time one of Roosevelt's collaborators approached the French Ambassador and informed him that the US government was unhappy at the lack of interest shown by the French in a projected currency stabilisation accord. The French government retorted by calling for monetary discussions ahead of the London Conference which would

[38] Quoting Bussière (1988), "*Sur le plan financier les Américains proposérent la constitution d'un fond commun devant permettre dans un premier temps une stabilisation de fait des monnaies: Paris refusa de s'y associer. D'autre part le gouvernement américain proposa de lier la stabilisation des monnaies à une trêve douanière qui suscita de fortes réticences de la part des Français.*" p.708.

[39] source: "*Conditions dans lesquelles la délégation française...*" M.F..

involve central banks and Treasury officials. According to the French Financial Attaché in London the UK government was not too happy with the idea of an exchange stabilisation fund. London would wait on the US's decision on these matters. The US delegates informed their French counter-parts that agreement on a bilateral sterling/dollar rate would not be easy.

However, on 18th May, Governor Harrison of the FRBNY informed Moret that he had been permitted to enter into negotiations with both the Bank of France and the Bank of England, though it was understood that this would in no way commit the US government. On the 19th May the French Financial Attaché in Washington telephoned Paris to inform them that a major hurdle on the way to a Tripartite Accord had been crossed, namely that purchases of foreign exchange used in exchange support operations would be refundable at the gold purchase price (the later Tripartite 24 hour exchange guarantee scheme was introduced in part for similar reasons). Monick, though, was already warning that the US was cooler to the idea of an exchange fund than in April. And on the same day Sir Charles Hambro, acting on behalf of the Bank of England, was telling his counter-parts at the Bank of France that the UK was strongly opposed to such a fund. Presumably British opposition stemmed from the fear that this would reduce its monetary discretion and that it could lead to disputes with the US over the optimal rate for the "cable" (the sterling/dollar bilateral exchange rate). The French and British representatives agreed that at the outset there should be a firm commitment from the US. They did agree to further discussions, but rejected the US proposal in the form in which it had been submitted.

The Bank of France insisted with Harrison on 22nd May that the three governments be represented at the talks. On the 24th May the French Financial Attaché in London, Monick, renewed his warning that the UK remained opposed to the creation of a joint stabilisation account and reiterated its view that the US should use its own resources to defend the dollar. The outcome of these soundings was that the US government would be willing to conduct parallel monetary discussions in London during the World Economic Conference. This meant that even before the World Economic Conference it had been decided that one of the most important issues affecting international economic stability would, in practice, be effectively removed from the main conference agenda.

The French Ambassador in Washington, de Laboulaye, who received the US proposal on 28th May, argued that this compromise illustrated the lack of interest on the part of the

UK government in reaching an accord before the main conference met. Nevertheless, though the isolationist camp in the US was gaining ground, the initiative still indicated that the administration remained keen on agreeing some form of stability. As it proved this certainly appears to have been the case as far as the US delegation to the World Economic Conference was concerned, which appears to have been negotiating in good faith, but it turned-out to be a quality not shared by President Roosevelt.

Sayers (1976) has studied monetary stabilisation ahead of the London Conference in the Appendix to his, History of the Bank of England.[40] His analysis gives more details on the anglo-american side of the discussions and the stabilisation measures considered. On the basis of Bank of England sources, Sayers suggests that the British were prompted to discuss currency matters following the depreciation of the dollar. The anglo-american talks were conducted between Leith-Ross and Warburg. They took place around the 25th April and on the question of the bilateral exchange rate, a cable rate of "$3.50 was the highest dollar value of the pound tolerable for Britain."[41] When Warburg approached the French authorities he apparently found them favourable to some form of exchange stabilisation, but they had not yet received instructions from Paris. According to Sayers there were already difficulties on the US side, with the President unwilling to compromise his policy aimed at raising the domestic price level, whilst the British had made no progress on the War debt issue which they considered a precondition of "any complete" stabilisation.[42] According to Sayers French interest had cooled-off by the second week in May because of the complexity of arrangements between exchange accounts. The French of course did not have one.

Nevertheless, it appears that by 15-16th May the French represented by Monick suddenly pressed for an accord. Warburg suggested a stabilisation fund of $500 million for each government (an earlier plan drafted by Crane of the FRBNY had proposed $250m. each). This would be for a three month period, renewable. According to Sayers the British were particularly concerned about the rates at which exchanges would be stabilised. "On the rate, the British authorities were fearful that the Americans and French would argue from the current level, which at $3.91 and 86 francs to the pound was regarded in London as

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[40] Sayers (1976), Appendix 27.

[41] Sayers (1976) Appendix p.277.

[42] Sayers (1976) Appendix p.276.

unrealistic."[43]

The Bank of England and Bank of France discussed the matter on 19-20th May and agreed that they would need a clarification of US credit policy before embarking on stabilisation. They were undoubtedly afraid that without guidelines on US credit policy a stabilisation agreement could commit them to absorb large quantities of dollars. However, on the 30th May, Sprague for the US government, informed his British counter-parts that there would be no early stabilisation of the dollar and that Warburg's plan was no longer in the picture.[44]

Mouré (1991) provides additional details of this mooted tripartite currency defence fund. The UK, US, and France would contribute equally, whilst a 15% devaluation of the dollar was envisaged. Mouré dates this proposal to the 26th April. Herriot, who was conducting the negotiations pressed for early acceptance in case US policy should change. However, as we have seen neither the Bank of France nor the Ministry of Finance saw why they should contribute to a fund not knowing what US policy might be nor did they think that the UK would condone such a dollar depreciation. The British view being that the dollar could be held at par. The contribution from France envisaged for the fund was $500 million.[45] Eichengreen argues that Roosevelt was sincere in his willingness to stabilize the dollar at 15% below par before the Conference, whilst his advisors suggested 25%. However, he adds that the French and British did not accept the "rate nor the mechanism" and "The three powers agreed only to negotiate a convention to stabilize currencies for the duration of the conference."[46] Mouré (1991) notes the French view that the continued depreciation of the dollar would ensure UK support for a stabilization agreement, hence the frustration of those such as Bonnet when Britain declined.[47]

One should note that failure to arrive at a currency stabilization agreement explains why the French authorities refused to endorse a formal tariff truce, as tariff retaliation remained a policy tool to be employed against exchange dumping. This why the French

[43] Sayers (1976) Appendix p.278.

[44] see Sayers (1976) Appendix.

[45] see Mouré (1991) pp.94-96.

[46] see Golden Fetters, p.332.

[47] Mouré (1991) p.99.

authorities only reluctantly agreed to a temporary truce for the duration of the Conference,[48] as did the British.[49]

The negotiations opened at the UK Treasury on 10th June and two tendencies were apparent within the US delegation. The first was favourable to a Tripartite agreement, whilst the other was more concerned about the risk of compromising the rise in US prices and argued for some "elasticity" or flexibility. However, the US delegation proposed that an accord be reached in favour of currency stability, ensuring that currencies did not depreciate for the duration of the Conference, but which would permit action under certain "catastrophic" conditions. Cordell Hull at the opening of the Conference on 14th June called for measures necessary to ensure the greatest possible monetary stability during the period in which the basis of a lasting reform could be established. Conversations lasted between the 10th and 16th June. The UK Treasury adopted a cautious stance, which the author of the French Finance Ministry memorandum ascribes to the UK's desire to secure an acceptable sterling dollar parity.[50] The French position was conciliatory, though they made it clear that no economic accord could be reached without monetary stability. The memorandum points out that this view was fully endorsed by the French parliament. On the 15th June a draft agreement had been finalised which apparently satisfied Hull, Cox (who was named President of the Monetary Commission of the Conference), Warburg, Bullit (sic.) (t); it also met with the approval of the UK side, consisting of the Chancellor, Neville Chamberlain, Sir Frederick Leith-Ross, Sir Frederick Phillips, M. Waley; on the French side these were, the Minister of Finance Bonnet, Bizot, and Rueff. On the 16th June the draft met with the agreement of the central banks concerned. This was a limited accord in which governments would state their monetary objectives and would agree not to implement measures, bar exceptional circumstances, incompatible with maintenance or restoration of currency stability.

Looking at the draft agreement,[51] dated 17th June and entitled "*Projet de Déclaration*

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[48] see Mouré (1991) p.89, footnote 36.

[49] see Clavin (1991).

[50] The memorandum is entitled, "*Conditions dans lesquelles la Délégation Française...*",(*vide supra*).

[51] Included in Appendix of this thesis.

par les Trois Gouvernements à la Commission Financière de la Conférence de Londres,"[52] one sees that the draft document was really quite non-committal. France re-affirmed her commitment to the free working of the gold standard, whilst the US and UK merely recorded that the ultimate goal of their respective monetary policies, under appropriate circumstances, was the stabilisation of their currencies on gold. Paragraph 5 though did commit them during the duration of the Conference to limit as far as possible exchange fluctuations, whilst the Conference itself tried to establish the basis of a lasting settlement which all three governments could agree to endorse. Paragraph 6 stipulates that though it does not aim to determine firm exchange parities for currencies not on gold the three governments agree not to adopt financial policies incompatible with the objective of maintaining or restoring monetary stability, aside from exceptional and unpredictable circumstances. Paragraph 7 provided for a temporary co-operation agreement between central banks.

A draft of the projected currency stabilisation agreement is in the archives at the Ministry of Finance, this is the, "*Accord Technique entre la Banque de France, la Banque d'Angleterre et la Banque de Réserve Fédérale de New-York,*"[53]. This would have committed both the Fed. and the Bank of England to make all efforts to maintain their currencies at certain parities, the figures were left blank to be negotiated, and the Bank of France would guarantee the gold convertibility of French francs delivered by both banks at the till of the Bank of France. The commitment on the part of both the Fed. and the Bank of England would be effective to the extent of certain prearranged sums of gold which both would agree to be willing to expend in order to support their currencies,- again the relative entries were left blank. Once any of the three central banks involved had made net gold losses above a certain unspecified amount this agreement would become null, though it could be renewed under the same or altered exchange rates and gold support guarantees by mutual agreement between participating banks. Only gold delivered or held under ear-mark at the central banks in question and at the Bank for International Settlements would count under the paragraphs relating to gold intervention limits. Under a specific paragraph heading it was held that whilst central banks could dispose freely of foreign exchange the conversion of dollars held at the Bank of England into gold or foreign exchange would be subject to a

[52] source: M.F., B 32 323.

[53] source: M.F., B 32 323.

mutual understanding between the Bank of England and the Federal Reserve Bank of New York. This was obviously to avoid the US extending a tacit exchange guarantee on pre-existing dollar balances held at the Bank of England. Under paragraph six it was agreed that this agreement would remain secret and that the respective governments would limit their public statements to confirming that whilst awaiting the outcome of the World Conference a temporary agreement had been reached between the three banks and that this aimed at securing currency stability.

Mouré has further details of this draft agreement from Treasury and Bank of England sources.[54] These sources give a more detailed account of the proposed exchange rates and intervention limits to support the exchanges. Mouré states that a figure of £20 million sterling was initially mooted as an agreed intervention fund ceiling for each central bank. A figure of $60 million was eventually agreed, or a maximum of three million ounces of gold. The agreement could be terminated once any one bank had reached this limit. These funds would be used to keep currencies within their gold points, a margin of fluctuation of 3% either way. However, Clarke (1973) suggests that the margins were set at 1.5% either way. On the rate for the cable Mouré states that, "The British had very reluctantly agreed to a $4 pound with provisions for a 10 cent revision downward at the end of two weeks." According to Clarke this rate would yield a dollar/French franc rate of $0.0466.[55] Mouré's sources (Treasury and Bank of England) date this proposed agreement on 11-12th June. One should recall that in April the British government considered $3.50 as an upper limit. Eichengreen dates this provisional agreement to the 15th June and quotes an agreed rate of $4 per pound sterling with a permissible rate of fluctuation of ± 12 cents for the conference duration, or three per cent either way.[56]

However, according to the Finance Ministry memorandum,[57] the press got wind of this draft agreement and it was reported that sterling and the dollar would be stabilised.

[54] Mouré's (1991) source for the intervention limits, left blank in the Ministry of Finance and French Treasury draft is, Foreign Relations of the United States, 1933, I: Sprague to Woodin, 16/6/33, 643; see Mouré (1991) p.105, footnote 103; see also Clarke (1973) p.32, footnote 38, who uses Federal Reserve Bank of New York sources.

[55] Clarke (1973) p.32.

[56] see Golden Fetters, pp.332-333.

[57] see: *"Conditions dans les lesquelles la délégation française..."*, M.F..

Mouré suggests that it was leaked by the French. However, he does not suggest that this was deliberate.[58] It is unlikely that it would have been deliberate as it undermined French objectives. The resulting fall on Wall street, and of commodity prices,[59] appears to have prompted a veiled disclaimer, on 16th June, from the Secretary to the Treasury, Morgenthau, who declared that any monetary agreement would have to be reached in Washington. Nevertheless, on 22nd June when Roosevelt declared that he was not of the opinion that now was the right time to adopt temporary stabilisation measures, the French memorandum (*vide supra*) states that the US delegation was just as surprised as anybody else.

New forces appeared to be exercising their influence in Washington. Following this incident the French delegation concluded that there was little point in carrying on the negotiations as speculative US interests would hamper any action in favour of stabilisation by President Roosevelt.[60] The reference to speculative US interests characterises the French concern with the direction which US policy was taking. The author of this note was perhaps too charitable to President Roosevelt as there appears little doubt that the President himself was instrumental in the change of policy.

From then-on French distrust of the US administration and the President, in particular, in economic and monetary affairs was set to grow and, as subsequent remarks by Leith-Ross were to make clear, these sentiments were shared by the British. It also appears that Roosevelt's own advisers were dismayed at his volatility. Quoting Clarke on Roosevelt, "Indeed, his pursuit of apparently incompatible goals and his unpredictability were sometimes the despair of his technical advisers."[61] This record of events tends to invalidate the view often held that it was the French who scuppered this initiative.[62]

Clarke (1973) has pointed out that though the proposed $4.00 rate was well below the then prevailing rate of $4.15-4.25, which the President appeared to be contemplating, what

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[58] Mouré (1991) p.106, footnote 107.

[59] see Eichengreen Golden Fetters.

[60] Quoting this internal memorandum, "*Instruite par cette expérience, la Délégation française en tira immédiatement les conclusions, à savoir qu'il était vain de chercher à avoir, à bref délai, l'accord des Etats Unis à une formule quelconque de stabilité. Il était clair, en effet, que les intérêts spéculatifs américains s'opposaient à toute action stabilisatrice du Président Roosevelt.*" (F.M. memorandum p.9).

[61] Clarke (1973) p.26.

[62] see for example Bussière (1988).

the President had objected to most of all was the clause which stipulated that no country would take measures to undermine currency stability, excepting exceptional circumstances. Apparently Roosevelt had become increasingly sceptical of the value of such a commitment lest it prejudice his policy of raising the domestic price level. Later the President would appear to be suggesting a rate of $4.15, with bands of 2.4% and later still a rate of $4.25. However, Clarke states that, "By the end of June, the President had backed away altogether from government stabilization measures."[63]

Clarke also suggests that, "Roosevelt's insouciance may also account for the poor quality of his appointments to the United States delegation, whose members were unable to work in harness, were diplomatically inexperienced, and were sometimes totally uninterested in the work of the conference." This is perhaps rather harsh on the conferees,- there is no criticism of their abilities from French sources. What French sources did despair of was the lack of guidance from the President who was off on a fishing trip. Another difficulty which Clarke alludes to is the fact the delegates to the monetary conference, O.Sprague for the Treasury and Governor G.Harrison, did not report to Secretary Hull who headed the delegation to the main conference, but to the Secretary of the Treasury and the Federal Reserve Board respectively.[64] However, this organizational fault can only be blamed on the President. Clarke also points out that Roosevelt had not asked Congress for authority to act on tariff matters, which meant that Cordell Hull was effectively empty-handed at the Conference.[65] Clarke also records that the British proposal for a 1.5-2bn. dollar stabilisation fund to make low interest rate loans to central banks to stabilise exchanges, "remove exchange controls and reduce other barriers to international trade," was rejected as the US public would not be favourable given existing defaults.[66] However, Clarke's reference to a British proposal for a stabilisation fund of this magnitude is very much at odds with the report British opposition to a stabilisation fund recorded in French sources (*vide supra*).

[63] Clarke (1973) p.34.

[64] Clarke (1973) p.30.

[65] Though HMG had made it plain that its Imperial Preferences were not up for negotiation. see Clavin (1991).

[66] Clarke (1973) p.22.

In the archives of the Ministry of Finance is a copy of another draft agreement, it is undated and may well be the one of the earlier draft accords which would have come into operation at the beginning of the London Conference. This document is entitled "*Projet de Convention de Stabilisation, adopté au début de la Conférence de Londres.*"[67] This paper boldly states, at the outset, that all countries must remain sovereign in their ability to fix their exchange rates and the date at which they choose to stabilise their currencies. The paper goes on to state that having regard to these provisions currency stability should be restored as soon as possible and that gold should constitute from then-on the unanimously accepted international standard, excepting the silver standard states. It then goes on to stipulate certain conditions aimed at economising gold, which clearly reflect UK strictures of French monetary policy (it is unclear from whom this draft proposal emanated, but presumably the French Finance Ministry). Amongst the measures to economise gold is the condition that it should be used in international settlements only, and that gold convertibility, where it exists, should be suspended for a period of five years and that convertibility should only be maintained for sums greater than FRF 220,000. In practice these terms would probably conform to the gold convertibility provisions of the French monetary law of 1928. A gold cover reserve ratio of 25% was recognised as being adequate,[68] though discretion to bring reserves to this level would remain with the governments concerned in view of varied existing conditions. Paragraph five is a sop to US silver interests and calls for the replacement of smaller denomination notes by silver coins whose silver content should not be under 800/1000, this is contingent on prevailing national budgetary and financial conditions.

The proposal included a commitment on the part of governments and central banks, whose currencies were no longer on gold, to adopt measures aimed at avoiding all abnormal fluctuations of their currencies and in particular those due to speculative pressures, with the aim of maintaining existing exchange relationships. The signatory governments would agree that one of the main objectives aimed at, within the context of stable currency relationships, would be a "correction" (i.e., rise) in world commodity prices which would make it easier to maintain exchange relationships. This is rather an awkward compromise. A rise in

[67] source: M.F., B 32 323.

[68] This had been recommended in the League of Nations: Gold Delegation Report (1932).

commodity prices alongside exchange rate stability would only be compatible if a tightly co-ordinated policy of reflation were adopted, or devaluation of currencies against a world commodity price index or gold. But, even this would do nothing to alter the balance of supply and demand which was responsible for the existing terms of trade and devaluation by the world vehicle currencies in which commodities were invoiced in, namely sterling and the dollar, could even have a short-term deflationary effect until the domestic impact of devaluation allowed a relaxation of monetary and macro-economic policy which could then stimulate world demand.

The agreement stipulated that measures be taken to ease, as far as possible, credit conditions. The methods to be used by the signatory central banks would include foreign exchange intervention or appropriate measures on the domestic market. However, the principal object would still remain currency stability, "*l'objet premier de leur politique devra formellement demeurer d'assurer la stabilité de la monnaie dont elles ont la charge.*"[69] One can understand that the US government may have found this too constraining particularly if one thinks of the manner in which the US had abandoned gold and steadily depreciated the value of the dollar through purchases of gold and silver at increasingly higher prices. This policy, completely contrary to monetary orthodoxy, could only be considered dangerous and heretical. Section C of the document included a recommendation that governments should, with due regard for their budgetary situation, encourage profitable public works (*travaux publics rémunérateurs*), rather a contradiction in terms, in order to make use of any available margin for credit expansion on the basis of existing reserves. The public works should preferably be co-ordinated and of an international character. However, this section is very loosely framed and would not commit anyone to anything much.

Section D recommended that in order to facilitate the lifting of exchange restrictions in countries which might find it difficult to do so the signatory governments would be willing to study within a time frame of six months,- in conjunction with their central banks, the League of Nations and the BIS and within an international framework,- methods of opening lines of credit to facilitate exchange convertibility which might include the extension of an exchange-risk guarantee. Section E states that governments agree to take account of their balance of payments position when determining their policy stance. Creditor countries would

[69] "*Projet de Convention de Stabilisation,*" M.F., B 32 323, p.3.

try and adjust their commercial policy accordingly, whilst debtor countries would pursue a policy aimed at ensuring that they would be able to fulfil their obligations. However, it provided that creditor countries should recognise that certain adjustments, either temporary or permanent, might be required to existing debts in order to allow debtors to consolidate their position. This was obviously meant to refer to the war debt owed to the US and it is arguable that, whatever the position of the Administration, Congress would not have permitted any substantial revision (see the subsequent 1934 Johnson Act which prohibited lending to governments which had defaulted on their foreign debt).

However, the failure of any of these negotiations to issue in an agreement was beginning to have an impact on currencies which remained on gold and particularly the Dutch guilder and the Swiss franc. It would become increasingly apparent that the fate of the remaining gold currencies would hang together. Thus, were set in motion the forces which made for the essentially defensive Gold Bloc strategy.

On the 22nd June Bonnet approached MacDonald to tell him that in case the US should refuse to endorse a currency agreement the consequence would be increased speculation,[70] in particular if the UK would not make a statement in favour of sterling stability. European public opinion was particularly afraid of the consequences which a fall in the value of the dollar would have on sterling and the impact that this would have on the gold currencies, as it would it make their economic position all the more untenable. As we will see one of the proximate causes of the Belgian franc's devaluation in March 1935 was a result of the weakness of sterling which put an added strain on the adjustment process amongst the Gold Bloc countries which had already deflated for a number of years.

Bonnet was obviously increasingly worried and told the British Prime Minister that he would be willing to reach any accord with the UK, which the US could then choose to join later. Failing that France would be party to any agreement which the UK would be willing to agree to. Archival material at the Bank of France indicates that Bonnet wanted to make all efforts to carry the British along with some form of currency stabilisation accord or failing that even a statement of intent before finally agreeing to set-up the Gold Bloc.[71]

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[70] see: *"Conditions dans lesquelles..."* M.F..

[71] Quoting from the minutes of the Conseil Général held at the Bank of France on Thursday 29 June 1933, at which the Governor summed-up for the Regents of the Bank the state of the negotiations in London, *"Les Gouvernements des pays qui n'ont pas abandonné l'étalon-or sont tous prêts à affirmer leur intention d'y rester*

Bonnet had concluded that if an agreement could not be reached with the British then the Conference could not achieve any practical results.

As we have seen the British were cool all along about making any firm commitments in favour of currency stability and would certainly not go ahead without US participation. Drummond has succinctly summarised the opposing positions staked out in London, "Throughout the proceedings of the Monetary and Financial Commission, Britain had pressed for price increases through credit expansion and cheap money. India, Japan, Argentina, South Africa, and Australia had all agreed. But the Gold Bloc - Switzerland, Holland, Italy, and France - had thought that prices could best be raised not through monetary policy but through the restoration of confidence, which required a gold standard. Poland, Germany, Romania, and Yugoslavia agreed."[72]

As we will see positions staked-out in London were not to alter very much over the years. However, the London negotiations do demonstrate that the French did not embark lightly on what some have argued was a wrong-headed initiative, but rather because they felt that there was no alternative and they feared most the unknown, which a floating currency represented, particularly in a world in which more powerful currencies would be placed to retaliate. This apprehension was fuelled by the correlation which was felt to exist between, on the basis of past French experience, currency depreciation and inflation. It was only in 1936 when the US economy had begun to recover somewhat and France was on the threshold of a certain devaluation that an agreement was reached and even then it could be argued that it was agreed in order to ensure some US and UK say in the new French franc parity and as an opportunity to press France to reduce tariff barriers.

Bonnet's analysis of the dire consequences of the failure to reach an accord were proving correct and on the 26th June the Dutch and Swiss delegations approached him and

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fidèles. Mais M. Georges Bonnet voudrait amener l'Angleterre à s'associer à eux par une déclaration commune. Il a fait des démarches dans ce sens auprès du Gouvernement britannique. Celui-ci déclare qu'il lui est impossible, pour le moment, de s'engager à stabiliser la livre sterling d'une façon définitive, à un cours déterminé. Il semble avoir fait des réserves sur le projet de déclaration qui lui a été soumis pour y substituer un texte plus élastique. On s'efforce actuellement de trouver un terrain d'entente. Peut-être les Anglais ne voudront-ils s'engager que si les Américains s'associent à la déclaration commune, mais alors celle-ci devrait certainement être encore remaniée et perdrait une partie de sa portée."

"M. Georges Bonnet a indiqué nettement que, si un accord n'était pas realisé avec les Anglais, les travaux de la conférénce ne pourraient aboutir à aucun résultat pratique." (from *Conseil Général, Banque de France, séance du Jeudi 29 Juin 1933*, B.F., 7 H 194).

[72] Drummond (1981) p.171.

asked that Bonnet convene a meeting of countries still on gold.[73] MacDonald was apprised, and a meeting was held at Downing street on the 27th. The Dutch delegates warned that failing an agreement, the Netherlands would have to abandon gold. This would be despite a strong "technical position" (i.e., gold reserve), as a panic on the exchanges was imminent. Where-upon the Chancellor asked whether the situation could be redressed by means of a stabilisation agreement, Colijn's reply was that it could, "immediately."[74] According to the minutes of the meeting of the Regents of the Bank of France held on 29th June 1933, the Dutch central bank had lost in the period from 22nd April up to the 29th June FRF 1.8bn. And Trip, the Governor of the Dutch central bank, remained worried about developments and hoped that some agreement could be reached which would express solidarity between central banks and which would assist the process of defending the currency.[75] Discussions had been held between Trip and Farnier on the issue. The same minutes indicate that the Swiss were also losing gold in large quantities. However, Bachmann, the Director of the Swiss National Bank, apparently saw no need for assistance from other central banks. Though Mouré states that Holland and Belgium had threatened gold embargoes if no measures to help their currencies emerged from the Conference.[76]

The Dutch view was supported by Bonnet, Jung for Italy, and Francqui for Belgium. This meeting was attended by Cordell Hull, so the US delegation was by no means ignorant of the possible consequences for these countries if they failed to come to an agreement.[77] The Chancellor of the Exchequer agreed to prepare a draft paper which would try and answer the Dutch request. The Chancellor promised the agreement of the UK, though the draft statement would have to be carefully considered. The Chancellor remained silent on whether he took US agreement to the document as essential from a British perspective. However, the future Gold Bloc states were obviously not too confident and were preparing their own draft agreement. This paper was elaborated in such a way as to secure the participation of the UK. Nevertheless, according to the memorandum, the British government was still, on

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[73] see: *"Conditions dans lesquelles..."*.

[74] ibid., p.10.

[75] see B.F., 7 H 194.

[76] Mouré (1991) p.107, footnote 116.

[77] see: *"Conditions dans lesquelles..."*.

the 28th, attempting to secure US support for their draft paper. Moley, one of Roosevelt's personal advisers had just arrived from the US.

However, by this time the French Finance Minister, G.Bonnet, was already entertaining little hope that a satisfactory Tripartite agreement could be reached and wrote to the Chancellor to tell him that in his view attempting to reach an accord on this basis was a waste of time. Bonnet argued that an agreement between the other great powers would bring subsequent US participation. Bonnet urged the Chancellor not to subordinate his position to that of the US, which would in all probability be negative. The UK delegation though, preoccupied by commercial relations, continued on the 28th and 29th June to seek US participation, whilst the gold standard countries produced increasingly watered-down proposals in order to facilitate an accord. These were constantly rebuffed by the US.

On the 30th Moley, who had as yet not met any of the Gold Bloc country delegates, invited Rist and Jung to his office. It appears that the three managed to agree a suitable formula,- much to their surprise. This would consist in a reaffirmation by the Gold Bloc countries in the gold standard, whilst those countries with inconvertible currencies took note of this without in anyway committing themselves to a future value for their currencies. They also agreed that countries with inconvertible currencies would confirm Senator Pittman's statement to the effect that the final objective of their monetary policy was to restore, under appropriate conditions, an international monetary system based on gold. According to paragraph 1 a) states recognise the need for a prompt return to international currency stability whilst sub-paragraph b) states, "*que l'or doit être rétabli comme étalon monétaire international, la date et la parité auxquelles chacun des pays dont la monnaie n'est pas actuellement rattachée à l'or pourra entreprendre de stabiliser devant être décidées par les Gouvernements intéressés.*"[78] And they agreed to take measures which they thought best suited to limit exchange rate fluctuations in co-operation with other governments and central banks.[79] This text would appear to be the note entitled, "*Projet de Déclaration Commune des Gouvernements des Pays dont les Monnaies sont au Régime de l'Etalon Or et des Gouvernements des Pays dont les Monnaies ne sont pas à ce Régime.*"[80] At the top of the

[78] From, "*Projet de Déclaration Commune des Gouvernements des Pays...*" *see infra*..

[79] The sort of loose international co-operation agreement which is quite characteristic of the G-7 today.

[80] see M.F., B 32 323.

document is a manuscript comment stating that this draft had to be abandoned as a result of a US refusal.

This text was reviewed on the same day at the US embassy and those present namely, Bonnet, Jung, Moley, Swope, Couzens, Pittimann (sic.) and Sprague all agreed to submit it that very day to President Roosevelt who retained the final decision in the matter.[81] That evening two meetings were held at Downing street, but Moley failed to show. Stating that he had not yet been able to get in touch with Roosevelt. It was already clear that something was amiss; Bonnet, who had to leave for Paris that evening, reminded the participants that though he had co-operated in good faith he had never been optimistic of the outcome. Should his fears be realised he would still urge in the strongest possible terms that H.M.'s government endorse the agreement.

However, on the 1st July Roosevelt rejected the proposal and it was announced that a *communiqué* would be issued on the 3rd July. This prompted a request on the part of the Dutch delegation for an immediate meeting of the Gold Bloc countries (to be). The meeting took place at Rist's office. The Dutch and Belgian delegation insisted that immediate action be taken by the five governments and central banks concerned. However, it was decided to wait and see how the UK would react to the US *communiqué* and Rist made a short statement to the press. This cautious stance was almost certainly taken at the behest of the French government which still wished to secure some form of UK agreement or statement, however loose, in favour of currency stability. Nevertheless, a draft *communiqué* was prepared and forwarded to Paris.

Another meeting was held at Downing street at 17hr. on 2nd July. It still appeared that the UK remained hesitant about an agreement without the US. However, the Chancellor suggested that Sir Frederick Leith-Ross should try and draft a declaration which could be issued at the same time as the Gold Bloc *communiqué* which had just received the approval of Daladier, Bonnet, Moret and Escallier. A meeting was held at the Savoy that evening. However, though the UK declaration had certain positive aspects, from a French perspective, it also contained certain points with which the French delegation were not too happy, namely, reference to the Geneva experts' report, undoubtedly a reference to the Gold Delegation Report, with its concern to raise world commodity prices and measures to reduce gold

[81] source: "*Conditions dans lesquelles*"...

reserve ratios, which from a French perspective could be interpreted as a means of securing a redistribution of French gold. It was not felt that it would have the desired impact on public opinion and those present agreed that it would be best not to release it.

On the 3rd July the US *communiqué* was released, the Roosevelt "bombshell," which according to the memorandum shocked the US delegates as much as anybody else. Nevertheless, the firm stance of the Gold Bloc countries and the release of their own *communiqué*,- which effectively testified to the complete breakdown of the Conference,- reassured continental public opinion and stock markets remained unaffected. The minutes of the Bank of France state that the effect of the Gold Bloc *communiqué* was to immediately halt speculation against the Dutch guilder and Swiss franc.[82] A meeting was held on the evening of the 3rd July, at 18hr. in Downing street, at which Neville Chamberlain stated that the US declaration could not but help have a significant impact on the Conference (a euphemism by any stretch of the imagination), however it was decided that a reaction should wait on the next day's Executive Committee meeting at which the US interpretation of Roosevelt's declaration and its consequences for the prospects of the Conference could be heard.[83]

At the Executive Committee meeting held on the 4th July Colijn, the Dutch Prime Minister, stated that the work in most of the sub-committees which he chaired had been suspended. He went on to argue that no progress could be made in the economic committees if speculative currency movements continued. Colijn argued that only the committees concerned with the rationalisation of production could usefully continue. His views were endorsed by both Jung and Bonnet. It was clear that the Conference was unravelling and had gone disastrously wrong, as a result of Roosevelt's selfish and ill-considered unilateralism.

Prime Minister MacDonald acknowledged that Roosevelt's *communiqué* was entirely at odds with the position adopted at their bilateral conversations in April. However, MacDonald added that he did not want to further complicate the US position and nor did he wish to simply end the Conference. The Chancellor adopted a more forthright stance arguing that there was little point in disguising the reality which was that there was very little point

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[82] Quoting from the minutes, "*Les résultats se sont fait immédiatement sentir, puisque la spéculation contre le florin et le franc suisse a été aussitôt arrêtée.*" *B.F., Délibérations du Conseil Général N. 123, 13th July 1933.*

[83] see: "*Conditions dans lesquelles...*".

in continuing. This view was shared by the Gold Bloc representatives, Colijn, Jung and Bonnet. The Executive Committee decided that its recommendation to the plenary conference office would be to adjourn, whilst maintaining in session the committees which could still usefully do their work. The plenary conference office met on the 5th and the US and Dominions, when informed of the previous day's decision by the Executive committee to adjourn the Conference, expressed their strong opposition and called for a delay. The Chancellor informed Bonnet that he would need time to confer with the Dominions and that he would support Bennett's (the Canadian Prime Minister) resolution recommending this. Bonnet's request for as short a delay as possible was granted. The memorandum argues that a clear effort was being made to postpone adjournment of the Conference under pressure from the US and the Dominions. The edition of the Times of the 4th had come out against adjournment and the US delegates made it known that they would be issuing a new memorandum. Roosevelt's second *communiqué* appeared on the 5th, and though it was more conciliatory, the contents were little changed and it still emphasised the primacy of internal price stability before exchange rate stability.[84] The US it would appear was engaging in a diplomatic salvage operation in order to deflect some of the odium for having scuppered the Conference.[85]

On the 6th the conference plenary met again,[86] and the US and Canadian delegates still maintained their vigorous opposition to its adjournment, supported by the Chancellor. However, Bonnet and Jung argued that a break should be taken and that there was little point continuing until the situation became clearer. A committee was appointed to try and draft a compromise agreement. The following compromise was reached: the Gold Bloc states declared that they could no longer participate in committees dealing with monetary affairs. The plenary conference office would convene the various committees which would under these circumstances decide which questions could still be usefully discussed.

The various committees were convened on the 7th and within the economic committee

[84] For text see documentary Appendix.

[85] As we have seen Clavin (1991) adopts a contrary view and considers the failure of the Conference to reside in: lack of UK leadership; unwillingness on its part to discuss its tariff policy; and incompatibility of policies of a nationalist character, viz., tariffs and a managed currency float, with any international objectives which might issue from a world economic forum.

[86] see: "*Conditions dans lesquelles...*".

the views of the Gold Bloc prevailed, however in the monetary committee the Chancellor suggested that these items not be removed from the agenda, but simply given a different order of priorities. The votes cast gave a majority in favour of MacDonald's proposal, though continental European countries were unanimous in support of a proposal that only indebtedness remain on the agenda. During these proceedings the dollar continued to weaken.

Nevertheless, the French memorandum ("*Conditions dans lesquelles la Délégation Française...*", *vide supra*) states that by the 11th the mood had improved and the Chancellor proposed that the monetary committee should only examine the questions of indebtedness and silver. The silver question was throughout this period of particular interest to the US as Roosevelt for reasons of domestic political expediency, and in order to inject more liquidity into the US economy, was drifting toward a form of hybrid bimetallism. Re-affirming the impossibility of reaching any agreement in London was Senator Pittmann's declaration on the 12th that the US government felt unable to endorse a resolution prepared by the US President of the BIS, Gates Mc Garrah. Only a few days before Governor Cox had stated that this resolution would not raise any difficulties on Washington's part. It must have been clear that it really was hopeless trying to negotiate with the US delegation until they had received fresh instructions.

Part of the problem was undoubtedly the *ad hoc* way in which Roosevelt reacted to the depression, constantly making policy on the hoof.[87] Though Roosevelt's economic policy often appears as a set of *ad hoc* pragmatic responses, as opposed to Hoover's policies which probably rested on surer analytical foundations.[88] It is interesting to note that Roosevelt's policy, as encapsulated in his controversial 1933 declaration, was very much in line with a monetarist view aimed at securing domestic price stability[89] rather than obliging the economy to adjust to the golden rule imposed by the fixed exchanges. The US and UK now intent on raising wholesale prices to restore equilibrium between prices and costs rejected stabilisation.

According to the memorandum the Conference soldiered-on in a non-controversial

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[87] see Stein (1969).

[88] see Stein (1969).

[89] see Friedman & Schwartz (1963).

way until the 27th when it was suspended. Clearly none of the parties any longer had any illusions about the outcome and though work continued, it would appear that this was largely as a face-saving exercise. In that sense the fact that it was not immediately adjourned following Roosevelt's "bombshell" could in a way be considered a diplomatic coup for the US delegation as it deflected some of the animus for torpedoing the Conference. The UK's attitude can probably be ascribed to pressure from the Dominions to prolong the Conference. As the Conference was chaired by the British government it is most likely that it felt obliged to play-along with these demands to demonstrate its good-will. Nevertheless, one cannot avoid the judgement that the London Conference was a complete failure and that this was principally because of Roosevelt's personal stance and not due to the US delegation which appears to have been willing to make an effort at drafting a form of face-saving *communiqué*.

However, it is important to note Eichengreen's emphasis on domestic forces impinging on Roosevelt's decisions. Eichengreen also argues that it is somewhat unfair to solely blame Roosevelt for the outturn of the conference. For, as the main protagonists did not share the same conceptual models, certainly not the anglo-saxons and French, there was little prospect of finding common ground. The different conceptual models thesis is illustrated by the fact that whilst the British and French authorities were agreed that coordinated action would be best, the British envisaged this within the framework of a policy aimed at raising commodity prices, whilst the French meant coordinated action aimed at restoring the gold standard.[90]

Eichengreen suggests that under better circumstances there might have been the possibility of a trade-off, with the French trading tariff concessions against an agreed dollar devaluation and a commitment to stable exchanges.[91] However, Eichengreen argues that under existing circumstances the French Prime Minister, Daladier, would not have been able to carry this policy with part of his domestic constituency which represented farming interests, as farmers enjoyed protection and were clamouring for minimum wheat prices.[92] And the US President was under pressure to reflate. One should also note the unpopularity

[90] see Eichengreen Golden Fetters, p.335.

[91] Though Eichengreen does not mention the implicit conclusion of his previous work (*vide* "Sterling and the tariff") viz., that British Imperial Preference was not up for negotiation. See also Clavin (1991).

[92] Golden Fetters, p.336.

of a return to a fixed exchange parity in the UK. Eichengreen argues that trade liberalisation would have eased any balance of payments constraints operating on the anglo-saxons. However, given Eichengreen's underlying explanation for the spread of depression, the perverse effects of fiscal orthodoxy, and the policy incompatibility between maintaining a fixed exchange rate and acting as lender of last resort to the banking system, it is just as well that the US acted unilaterally.

Eichengreen's assessment of the outcome of the Conference is that, "domestic political impediments and disagreements in France, Britain and the United States over the role for monetary policy would have impeded the negotiation of a cooperative solution even if the dollar had remained tied to gold."[93]

We have chosen to look closely at the official French version of events at the London Conference because this experience was to colour French policy-makers' attitude in many of the subsequent negotiations and discussions concerning stabilisation. There is no doubt that France left the Conference with the impression that the US, and particularly the President, was a totally unreliable negotiating partner and that for the time-being there seemed little hope and prospect of any agreement. Leith-Ross was subsequently, in private conversations with his French counter-parts, to indicate that he shared this view. Whatever one might think of the merits of Roosevelt's efforts from a US domestic policy perspective there is no doubt that his "bombshell", which he appears to have drafted without any consultation with his team in London, was, from an international perspective, distinctly unhelpful. It may well have been better if a conference had not been convened at all.

What the Conference does highlight is the degree of continuity in French policy, for although they were not yet considering devaluation it was clear that they would not act outside an international accord of some sort. As it turned-out the Tripartite, which allowed the devaluation of the French franc, was, as appears in its very loose commitments, quite close to what some discussants appear to have had in mind in London. Though in London the French authorities were not yet considering devaluation as part of such an accord, by 1935 it was certainly an accepted/able objective. When the Popular Front government devalued in 1936 it argued that the co-ordinated international approach which they had adopted conformed with French monetary policy objectives pursued since 1933. Of course,

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[93] see Golden Fetters, p.337.

even without the unilateralism of the US it was clear that the UK was very reluctant to enter into any exchange rate commitment and that in particular there would have been difficulties with the US over the bilateral "cable" parity to adopt (sterling/dollar rate),- this would also crop-up later. But at least the UK government would have been prepared to go-ahead with some loose declarations aimed at reassuring financial and foreign exchange markets.

In the event US intransigence probably strengthened the case in favour of continued deflation in France (as Strohl has argued),- for France, abandoning gold would have been a journey into the unknown. The uncertainty was compounded when Roosevelt stabilised the dollar at 59% of its former parity in January 1934, whilst still retaining the facility, under the amendment to the Agricultural Adjustment Act to reduce the gold parity of the dollar to 50% of its former parity. Thus raising the prospect that any unilateral French action might be matched by a compensatory devaluation of the dollar. In such circumstances the UK Exchange Equalisation Account could like-wise allow sterling to float down. The fact that France had levied compensatory tariffs (and quotas) on countries which had devalued with sterling in 1931 made the French wary that a franc devaluation might also invite a further raising of tariff barriers. These events will help us understand France's subsequent tenacity in holding to its gold exchange standard and the Gold Bloc until some co-ordinated international solution could be found. As we will see we now know that even in 1935, France was engaged in secret soundings both in Washington and London, aimed at reaching some form of stabilisation agreement.

The French are often blamed for their reluctance to enter into a "negative" agreement not to raise tariffs or introduce trade protective measures during the duration of the London Conference. Eventually they did accede to a limited agreement, however given the US's intransigence on currency matters and the imported deflationary impact of a drop in a currency such as the dollar[94] it is hardly surprising that the French authorities were very reluctant to enter into any such binding agreement.

[94] This is both Friedman and Kindleberger's explanation of the spread of the depression from the US, the former attributing it to the contraction of the money supply, whilst the latter sees the mechanism originating in the banking collapse and the lack of lender-of-last-resort. There are obvious similarities, but Kindleberger focuses more on systemic problems both domestically and internationally.

THE GOLD BLOC:

On the same day that Roosevelt delivered his fateful *communiqué*, on the 3rd July, which left no more room for compromise, the Gold Bloc issued its own declaration.[95] This was obviously the product of previous discussions conducted between those countries to whom it had become increasingly apparent, as Bonnet had foreseen, that a general currency agreement was highly unlikely. This declaration states that the signatory governments are convinced that the stability of their currencies is essential for the economic and financial improvement of the world and the renewal of credit (of great importance if one subscribes to a "loanable funds" theory of savings and investment) as well as for the preservation of social improvements accomplished in those countries. The latter stipulation is an obvious reference to the view that devaluation would erode real wages through inflation, and was in a sense a way of co-opting labour support for this policy stance. The declaration then goes on to commit the signatory governments to the free functioning of the gold standard at prevailing gold parities within the context of existing monetary laws. The declaration requests that the central banks concerned remain in close contact in order that this declaration might meet with the greatest effect. The signatory governments were: Belgium, France, Holland, Italy, Poland and Switzerland.

Eichengreen places Czecho-Slovakia in the Gold Bloc, however this is a commonly reproduced misapprehension.[96] Czecho-Slovakia was on gold and even after devaluation in February 1934 still retained a formal gold parity. Nevertheless, it was not party to the Gold Bloc currency agreement, nor did it participate in the trade negotiations held within the Bloc. Danzig is also sometimes placed within the Gold Bloc, but though it was on gold it was not party to the Gold Bloc agreements.

As we have seen this declaration was part prompted by the need to bolster the Dutch guilder and Swiss franc. However, French participation was by no means disinterested because it was clear at the outset that a run on any one Gold Bloc currency would soon cause a chain-reaction and affect all the Gold Bloc currencies. The last paragraph of the declaration was a thinly disguised allusion to the fact that the signatory governments' central

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[95] see Appendix.

[96] Golden Fetters, p.313 & 350.

banks would be prepared to co-operate to support their exchanges. This had the hoped for effect and relieved pressure on the Dutch guilder and Swiss franc.

Eichengreen suggests that the signatory states to the Gold Bloc declaration pledged to make, "their collective reserves available in support of the weakest gold currency."[97] However, this is too strong an interpretation, it only pledge them to cooperate in defence of their currencies.

One should note, as Eichengreen points out that Algeria and the Netherlands East Indies were *de facto* members of the Gold Bloc, as both colonies used the currency of the mother country.[98] Eichengreen omits though to mention Indochina whose *piastre* was tied to the French franc and was also an effective member of the Gold Bloc.[99]

Eichengreen states that the guilder had come under pressure as uncertainty over the dollar suggested that sterling might be allowed to depreciate and so would the Scandinavian currencies which would have a deleterious effect on Dutch exports.[100] These difficulties were compounded by a dispute with Germany over the suspension of service on the Dawes and Young loans. This led to German balances being withdrawn in case they might be frozen by the Dutch authorities.

Following the Gold Bloc declaration H.M.'s Government formalised the sterling area, issuing the British Empire currency declaration.[101] And Eichengreen adds that Neville Chamberlain refused to sign the Gold Bloc declaration as this might undermine the sterling area if its members interpreted this as a signal of a return to dear money. The sterling area aimed at reflation within a single currency area.

A co-operation agreement to put the London Gold Bloc declaration into effect was reached between central banks meeting in Paris and signed at the Bank of France on 8th July 1933 (see Appendix). Article 1 of this agreement,[102] re-affirmed the London declaration

[97] Golden Fetters, p.338.

[98] Golden Fetters, p.358, footnote 11.

[99] see Pirou (1938) p.70.

[100] Golden Fetters, p.337.

[101] see Eichengreen Golden Fetters, p.338; and Pasvolsky (1933) for text of declaration.

[102] M.F., B 32 323, "*Accord de Coopération.*"

as the principle underlying the accord. Article II committed the banks to mutual assistance particularly against speculative runs and to adjust their credit policy, viz., interest rates, accordingly. Article III committed them to intervene on their domestic markets to support member currencies. These interventions would take place without commission and at cost price. Banks concerned would cover any outstanding balances on a daily basis in gold, at the gold parity of the currency of the intervening country, i.e., any exchange risk would be borne by the central bank whose currency was being supported. Article IV stipulated that each bank would be willing to ear-mark gold on account of any other Gold Bloc member and that this gold should remain free to be exported to any destination (the latter stipulation was a subsequent addition). Article V stipulated that the foreign exchange departments of the banks concerned would co-operate to put this agreement into effect and share any information which might be relevant to the objective of maintaining exchange parities. Article VI stated that the agreement was open to banks willing to join and those which, as a result, could help in maintaining the gold standard. Article VII stipulated that the agreement could be cancelled with one month's notice by letter addressed to the Bank of France.[103] The agreement would remain effective amongst the remaining signatories. Article VIII stated that the co-operation of the BIS would be solicited for any functions which might fall within its remit. Article IX would allow any one signatory to request a meeting of members party to the agreement in order to examine problems with implementing the accord. This would apply whenever the situation required it. At the head of the document it is stated that this agreement should remain strictly secret and should not be mentioned outside the confines of the central banks concerned. Also present was M. Fraser, President of the BIS, however he did not take part in the discussions.[104]

A more formalised agreement exists (see Appendix) entitled, "*Texte Définitif du Projet d'Accord entre la Banque A et la Banque B*,"[105] which aims at putting into practice articles III and IV of the 8th July co-operation agreement. These articles, as we have seen, are

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[103] The one month period of notice was a subsequent amendment to the accord suggested by Moret following an exchange of correspondence with Bachmann. Bachmann, the President of the Swiss National Bank, had requested that a specific clause be introduced into the 8th July accord to the effect that ear-marked gold could be freely exported from the depository central bank to any destination, both conditions were approved by all participating central banks, see reply from Moret to Bachmann dated 19th December, 1933, B.F.

[104] B.F., *Conseil Général*, 13th July, 1933, n. 123.

[105] M.F., B 32 323.

concerned with mutual intervention and ear-marking of gold to finance these operations. The paper in question merely sets out the conditions for gold ear-marking. It stipulates that the creditor central bank may request shipment of the gold ear-marked to its account. The borrowing bank B could always purchase its ear-marked gold with any residual balances from the proceeds of currency acquired for intervention purposes. The price at which gold would be purchased or sold is that at which the Bank had originally sold it, thus shifting the exchange risk onto the borrowing bank. A manuscript note at the head of this document states that this is the technical agreement put into effect with the Netherlands central bank and the Bank of Italy. The technical accord between the Bank of France and the Dutch central bank was approved at the *Conseil Général* held at the Bank of France on 29th June 1933, i.e., before the formal creation of the Gold Bloc. This was undoubtedly to provide support for the Guilder and thereby indirectly protect the franc, and all other remaining gold currencies. The agreement also had a provision stipulating that the expenses of shipping gold, whether it be imported or exported to France, be at the charge of the Dutch central bank.

The *Conseil Général* held at the Bank of France on 13th July confirms that the agreement between the Bank of France and the Dutch central bank was the prototype for the general accords agreed between central banks on 8th July. It confirms that all participating central banks had arrived at similar agreements between themselves. However, the minutes of the Bank of France specifically stipulate that these were merely technical co-operation agreements and in no-way committed the Bank of France to extending financial support to participating member states.[106]

At the plenary session which was to mark the end of the London Conference the Italian delegate, Jung, would, according to Strohl,[107] sound a bullish note concerning the vitality of the Gold Bloc, whilst denouncing systems based on principles of managed money

[106] Quoting from the minutes of the Bank of France which records this, "*Elles ont abouti à la signature d'un accord précis entre toutes les banques représentées, accord qui ne comporte de la part de la Banque de France aucune promesse de concours financier, mais qui règle les modalités d'une collaboration technique, en ce qui concerne notamment les mouvements d'or de Banque à Banque, les mesures de défense contre la spéculation sur les changes, etc... Chacunes des Banques à, en outre, conclu avec toutes les autres des accords particuliers analogues à celui qui est déjà intervenu entre la Banque de France et la Banque Néerlandaise, accords portant sur des points de détail, tels que les conditions de rapatriement de l'or placé sous dossier et la coopération entre les services des changes.*" (see B.F., *Délibérations du Conseil Général*, n.123).

[107] Strohl (1939) p.207.

"*monnaie dirigée*" or price indexes, a possible reference to Irving Fisher. Jung would also argue that it would be impossible to dismantle protectionist barriers so long as the world was subject to the threat of devaluation. In this context one might note that reference is often made to "beggar-thy-neighbour" trade policies, however predatory exchange rate policies may be just as hurtful, viz., exchange dumping.

Strohl (1939) highlights some of the weaknesses of the Gold Bloc, these are the large budget deficits which bedevilled certain of its member states, amongst these he identifies, France, Switzerland and the Netherlands. This was compounded, according to Strohl, by a deteriorating trade balance in France, Switzerland, the Netherlands, and the Belgo-Luxemburg Union (see Appendix for bilateral trade figures).[108] According to Strohl the only exception was Poland whose trade balance had improved in the period 1929 to 1933.

Strohl points out some of the restrictions on the free use of gold within the so-called gold standard countries.[109] This included the minimum convertibility for the French franc set at FRF215,000, the equivalent of 12.5kgs! of gold at 0.900 (a standard gold bar size). The Netherlands central bank would only deliver gold destined for fellow central banks which allowed the free flow of gold. Strohl states that this was introduced to counter domestic gold hoarding tendencies. The Swiss National Bank could deliver gold, gold coin or foreign exchange against its currency and according to Strohl had, since 1931, in practice, only delivered foreign exchange acquired through sales of gold to the Bank of France. The Polish central Bank, though legally bound to ensure the gold convertibility of its currency, apparently only delivered foreign exchange. The Belgian National Bank which was on a gold exchange standard availed itself of this more flexible standard by delivering foreign exchange rather than gold. The Bank of Italy did so too, but as the stabilisation Law of 1927 which put Italy on a gold exchange standard did not stipulate that lira notes should be exchanged for foreign currency at a fixed gold parity it delivered foreign exchange against domestic notes at the prevailing (lower) market rate. Strohl points out that though the Italian authorities did intervene to maintain the foreign exchange value of the lira near its gold parity the lira could not be said to be on the gold standard and the system practised was that of a "*monnaie dirigée*." As we have seen even this was not to last beyond 1934.

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[108] Strohl (1939), p.213.

[109] Strohl (1939) pp.216-218.

Strohl's reminder of the real circumstances surrounding currency convertibility within the Gold Bloc reminds us that, just as the pre-war gold standard, the Gold Bloc was in effect very far removed from the idealised textbook model and that which many French policy-makers had to heart.

As we will see the Gold Bloc was never large enough to provide a relatively hermetic trade and currency bloc. The US economy was large enough not to have to worry about its traded goods sector which for many of the Gold Bloc countries represented their life blood, one has in mind particularly Belgium and the Netherlands, both of which were highly dependent on the German and UK markets. Italy's trade relations outside the Bloc remained more important. There was also a lack of complementarity which made it very difficult to engage in any substantial intra-Bloc trade liberalisation without offending entrenched interest groups. Belgium for example enjoyed lower prices, particularly for its industrial products than its fellow Gold Bloc states. This limited the extent to which other members might be willing to open their markets by raising quotas to admit more Belgian industrial goods. Dutch agricultural competitiveness was considered a problem for French agriculture, which was highly protected, a paradox given the continued policy of deflation pursued by several governments at the time. Reynaud would frequently allude to the paradox of protectionism alongside a policy of deflation which was at theoretical odds with the aims of deflation.[110] It was said that the Dutch practised agricultural dumping by means of generous export subsidies. An attempt was made to exclude Poland from efforts to liberalise intra-Bloc trade by confining membership at first to the contiguous western member states, "*les pays limitrophes de l'Europe occidentale.*" This was because agricultural member states did not want to open their markets to Polish produce. Swiss hoteliers would soon be offering discounts to British tourists to shore-up the Swiss tourist industry, which was a more popular tourist destination before the advent of modern jet travel and the cult of the sun. From 1934 Italy left the gold standard sheltering its over-valued currency behind myriad blocked currency accounts. This trend was reinforced following the Abyssinian conflict/invasion in October 1935.

According to Bussière's thesis (1988) the Belgians had originally been keen on the Gold Bloc because the French capital market had been a useful outlet for marketing

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[110] see chapter seven of this thesis.

government bonds to finance the budget deficit.[111] Bussière argues that the Gold Bloc, as a financial area had existed since 1930.[112] And that this reliance of the Belgian state on the Paris capital market was at its peak just as the London Conference was about to convene.[113] However, this relationship would become less important just as the Gold Bloc came into being. Bussière is of the opinion that attempted monetary integration came too late. Bussière argues that this important dependence of the Belgian state on the Paris capital market was at its height in the period 1930 to 1934. Belgian industry too had relied on the Paris and Amsterdam markets to place equity following the effect of the stock-market crash of 1929.[114] However, by 1932 the industrial downturn and financial crisis put an end to equity issues[115] and by 1934 the ability of the Paris market to absorb Belgian sovereign debt had also dwindled.[116]

Bussière argues, therefore, that just as the Gold Bloc was preparing to increase trade relations the dependence of Belgium on the Paris capital market was becoming less important and the relationship began to lose some of its meaning.[117] Bussière states that Paris accounted in the period 1930-34 for as much as 29.5% of the medium and long term finance requirements of the Belgian state and that in the period 1932-34 sovereign borrowing by

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[111] Quoting Bussière (1988), "*La Belgique se trouve donc placée au coeur d'un axe de coopération financière qui vise à alimenter son marché déficitaire en capitaux. Il se développa à partir de 1930-1931 dans le cadre de ce qui devait devenir le bloc-or. D'une certaine manière, un décalage entre tentatives d'intégration industrielle et tentatives d'intégration financière semble marquer cette deuxième partie des années vingt, la seconde venant après - trop tardivement - la première.*" p.550.

[112] "*...l'occasion d'une complémentarité entre marchés financiers belge et français, les entreprises puis le gouvernement belge recherchant sur Paris des moyens de financement. C'est cette complémentarité qui donne tout son sens à la constitution symbolique du Bloc-or à l'issue de la conférence de Londres 1933. En realité, en tant qu'espace de relations financières priviligiées il existait dès 1930.*" From Bussière (1988) p.616.

[113] "*Ainsi, au moment où va s'ouvrir la conférence de Londres, l'appui financier français à la Belgique tend à prendre des proportions essentielles pour ce pays.*" From Bussière (1988) p.634.

[114] Bussière (1988) p.623.

[115] Bussière (1988) p.625.

[116] "*Ces difficultés proviennent de la capacité d'absorption réduite du marché français à partir de 1934.*" From Bussière (1988) p.756.

[117] "*Le Bloc-or, tel qu'il se dessine pendant ces années, apparaît donc comme un espace de coopération financière étroite qui joue pleinement au profit de l'économie belge. En revanche il se constitue à un moment où les solidarités entre entreprises s'affaiblissent. Il souffre donc d'une faiblesse initiale importante au moment où s'ouvre la conférence de Londres.*" From Bussière (1988) pp.638-639.

Belgium, on the Paris capital market had taken the place of private equity issues.[118] Despite the decline of Paris as a source of capital the French market also came to be seen as a necessary outlet for the survival of Belgian industry.[119] Though as Belgian industry became increasingly insolvent due to deflationary policy, the banks would find that their balance sheets were beginning to groan under the weight of increasingly unserviceable company loans. Sterling weakness in March 1935 would be the straw that broke the camel's back and devaluation followed effectively bringing an end to the Gold Bloc experiment,- though it would continue to enjoy a half-life until the French devaluation in September 1936.

Bussière argues that the Gold Bloc was the result of a gradual development of a process of economic and political thinking in Belgium and that it gradually secured the support of some French policy-makers. However, existing difficulties and its hesitant nature suggested that this grouping of states was not the most appropriate from which to create such a bloc.[120]

Bussière casts the Gold Bloc within the mould of a three-fold periodisation of Franco-Belgian economic and political relations. These are, 1) the Franco-Belgian bilateral bloc ending in the Ruhr fiasco; 2) a period during which Belgium became more multilateral in its outlook, he refers to the 1927 World Economic Conference as an example; 3) the Gold Bloc period, and the creation of a regional sub-grouping. According to Bussière the level of Belgian exports to the French market were to be a prime determinant of this relationship.[121] Bussière argues that, setting aside the influence of political figures and policy-makers on the development of this relationship, it was really a business strategy of industrial and financial groups which dictated this policy orientation.[122]

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[118] Bussière (1988) p.628.

[119] *"Ici l'initiative est belge et vise à l'organisation d'un sous-espace régional permettant à son industrie de survivre."* From Bussière (1988) p.6.

[120] *"Elle est le résultat d'une évolution engagée dès 1931-1932 au sein des milieux économiques et politiques belges; elle a peu à peu rencontré l'adhésion de certains responsables français. Les circonstances et les hésitations du départ révèlent que ce groupe d'Etats ne constituait certainement pas la meilleure entité pour une première expérience de cette nature."* From Bussière (1988) p.719.

[121] Bussière (1988) p.9.

[122] Bussière (1988) p.9.

NEGOTIATING A TRADE AGREEMENT WITHIN THE GOLD BLOC:

Bussière (1988) reminds us that the Belgians who would be charged with convening a conference to increase trade within the Gold Bloc might have recalled the unfortunate precedent of the earlier Oslo and Ouchy accords. Belgium had adhered to the Oslo convention on 22 December 1930. It grouped Belgium, Denmark, Norway, the Netherlands, Sweden and Finland and was the product of a Norwegian initiative. The later Ouchy accord also foundered on the question of the most-favoured-nation (MFN) clause and a request by the British that preferential trade agreements give rise to some form of reciprocal compensation. The Oslo convention had suffered a similar fate.

One might also add that the results of the 1927 Stresa conference had been disappointing, particularly to French policy-makers who wanted to use this initiative to help prop-up the economies of agrarian Danubian basin countries to counter growing German influence in the area. Proposals for derogations from MFN tended to be rejected and Germany managed to put-off discussions at the League of Nations so that eventually the initiative was abandoned. These countries were already becoming too tied-into a system of clearings and bilateral trade agreements to be prised away from German influence. The record of attempts at creating localised preferential trading areas was not favourable. The Empire preference system was of course built on an all together different scale, within a pre-existing political framework, viz., the British Empire, it was also a low interest rate, floating common currency area (with the exception of Canada which was pegged on an evenly weighted dollar/sterling basket).

The Belgians were chosen to chair the discussions aimed at imparting an economic dimension to the Gold Bloc, namely the trade negotiations, in order to deflect any accusation that an ensuing agreement reflected French hegemonial aspirations. Bussière's thesis that the Gold Bloc was a Belgian initiative is somewhat contradicted by Mouré (1991) who states that the Belgians were ill-prepared for the conference, which is confirmed by official French sources (*vide infra*). These suggest that the French delegation had effectively to take control of the conference. Mouré has argued that lack of Belgian preparation should be ascribed to the fact that they were not keen on the initiative in the first place. However, this is at odds with other sources in particular Bussière who has studied the Gold Bloc *in extenso* from a Belgian perspective. Bussière argues, to the contrary (*vide supra*), that the Gold Bloc, and in particular its economic element or at least the attempt at creating a freer trade area, was a Belgian initiative. This appears supported by the fact that Belgium was the country whose trade within the Gold Bloc was the most significant as a proportion of its total exports, though it is true that none of the other member states was willing to go along with the French suggestion that the Gold Bloc members should request derogations from MFN. As we will see the MFN clause was to prove a very significant barrier to intra-Bloc trade liberalisation and the fear of retaliation by non-member states to quota liberalisation meant that little progress would be made on this front either.

The fact that member states enjoyed a different mix of tariffs and/or quotas meant that any alteration in a country's protective mix could trigger retaliatory measures or would require compensatory concessions. Furthermore, Italy, for example, did not have a significant system of quotas at this early stage and therefore felt hampered in any efforts to make reciprocal quotas concessions. Tariff concessions were explicitly excluded because of the problem of MFN and as we will see even quota concessions were impeded by the Franco-British agreement of 1st July 1934 which stipulated that any quota concessions extended by either state to third parties should incorporate a proportional increase in the bilateral quota allocation of the two signatory states.[123]

As we will see difficulties associated with trade liberalisation measures solely confined to the Gold Bloc would become apparent at the preparatory meeting held in Geneva on 24-25th September, and at the meeting itself which was convened in Bruxelles on 20th October 1934 to discuss intra-Bloc trade liberalisation.

It is interesting first to study some of the preliminary internal discussions which examined measures which could be considered at the Geneva and Bruxelles meetings. These are contained in files at the "*Ministère des Relations Extérieurs.*"[124] A letter dated 16/3/32 suggested that Holland and Belgium might soon be preparing a customs union (to become the Ouchy accord). This document went-on to suggest the possibility of such a union plus France as well as these countries' colonies (obviously the Ottawa system which was being developed held its attractions). The letter adds that such a union could attract the Swiss.

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[123] France had abolished its *surtaxe de change* on English products, which had been introduced after sterling's devaluation, this was done following the introduction of quotas at the end of 1933. See Bussière (1988) p.727.

[124] M.R.E., B *Questions Financières*, ibid..

The paper suggested that such an alliance would enhance France's influence in central Europe and the Balkans.[125] This increased influence would in part be derived from its greater size as a market, though how this could have offset the increasing ascendancy of the central European trade bloc organised around Germany is questionable. France's previous foray in this area marked by the Stresa conference, which had aimed at increasing France's influence in the south central European Danubian basin by setting up a scheme to support agricultural produce from this area, had not been a success and had met with resistance from the UK and Germany and had also encountered obstacles on the question of MFN.

The increasing predominance of Germany in central European trading relations as the 1930s wore-on was to be evident in the case of Poland. Poland which was included within the Gold Bloc, undoubtedly as a result of French foreign policy considerations, was to find itself increasingly enmeshed within the German central European nexus of monetary and trade clearing agreements. This was most apparent when Poland failed to follow France off gold in 1936 and devalue,- her trade was already caught up in a complex web of clearing agreements.

A paper dated 9/3/33 from H.Bouchet to Serre the Minister for Commerce and Industry suggested a gradual approach to an agreement amongst countries close to France geographically and sharing the same policies and that this would be easier to achieve than some global settlement, as sought at the London Conference. The paper suggested that an agreement between France, the Benelux and Switzerland should be undertaken step-by-step. This should begin with preferential bilateral agreements between countries, followed by some more generalised/multilateralised arrangement and eventually a customs union. Both papers tend to support Bussière's thesis that the idea of creating a trade bloc predated the London Conference.

The first essay at encouraging economic co-operation within the Gold Bloc was a private sector initiative begun by the Lausanne Chamber of Commerce. The committee created, the "*Comité de Rapprochement économique des Pays du Bloc or,*" on 7th July 1934 at Lausanne. The representatives of the Chambers of Commerce of the Belgo-Luxemburg

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[125] "*Pourtant, je ne peux m'empêcher de souligner le prolongement que pourrait avoir une quadruple entente: affermissement de nos positions en Europe Centrale et dans le Balkan, avance prise dans la lutte des influences, le jeu de nos alliances et l'accroissement de nos facultés d'absorption y suffiraient.*" *M.R.E., B Questions financières*, letter dated 16/3/32.

Union, Italy, the Netherlands, the Chamber of Commerce of the Vaudois Canton in Lausanne, the French Chamber in Geneva and the French Chamber in Lausanne committed themselves to create this *Comité* in order to promote trade within the Gold Bloc. The paper submitted to the Ministry of Finance argued that a co-ordinated approach of the Gold Bloc states and their colonies would allow them to fend-off pressure from other groupings as well enhance their negotiating strength.[126] The committee endorsed Belgian Foreign Minister Paul Hymans speech's delivered on 29-30th November 1933, in which he argued that closer economic relations between Gold Bloc countries were desirable. The committee's aims were limited to: promoting the Gold Bloc; highlighting monetary/exchange dumping and means to counter-act it; the study of the economies of the various states concerned; and the creation of national committees to promote increased economic integration within the Bloc. The committee informed the French government in this letter that all governments approached had been favourable to this initiative and helpful. A Belgian, Edgar Biart, was appointed to head this committee.[127]

Though agriculture was to be an impediment to further intra-Bloc economic co-operation, France appears to have encouraged members to allow Poland to join this private sector grouping. However, such a well-meaning private sector initiative was of no significance when compared to the real political problems which any policy aimed at fostering greater economic integration within the group would encounter. The committee was dissolved following the endorsement of the general principles which the *Comité* had promoted at the Geneva meeting of the west European Gold Bloc member states. The Geneva meeting (*vide infra*) took place on 24-25th September, 1934, and the *Comité* was dissolved shortly thereafter.[128]

A document which is interesting for the insight it provides into the difficulties intra-Bloc economic co-operation would meet is a paper prepared by the Chamber of Commerce of Marseilles entitled, "*Conclusion entre les pays ayant conservé l'étalon-or de Traités basés sur les principes d'Ouchy.*" This report was forwarded to the Ministry of Finance as it was

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[126] M.F., B 32 323, dated Lausanne 5th April.

[127] see *Ministère des Relations Extérieurs, Relations Commerciales 1919-1940, B Questions Financières - 57-7 Bloc or (1).*

[128] see document 172, dated 15 October 1934, M.R.E., B *Questions Financières.*

drafted with a view to adhering to the *Comité de Rapprochement Economique des Pays du Bloc Or*. The Chamber of Commerce paper was a reaction to a study by a Mr. Engelbrecht which had underlined the advantage of implementing an agreement similar to the Ouchy agreement. The Marseilles Chamber of Commerce also considered what would be the advantages of including Germany in such an agreement. On the latter question the emphatic conclusion was that given the managed nature of German trade it should not be party to any such agreements, and that an agreement should be confined to the Benelux. But the most interesting aspect is the very realistic and pessimistic view which this short paper takes of the prospects for trade liberalisation. It pointed out that the Ouchy accord which aimed at a progressive and reciprocal dismantling of trade barriers foundered after the Netherlands had *de facto* abandoned it (because of fear of UK retaliation?) and that the Oslo accord which aimed principally at freezing import restrictions had failed too. The paper added that the temporary customs truce, agreed before the London Conference, had already been formally abandoned by the Netherlands, Sweden, Switzerland, and France; that the Ottawa agreements were essentially protective; and that France itself had in effect abandoned MFN principles since 1st September 1933 as from then-on, in pursuance of the decision taken by the Council of Ministers, quotas were negotiated on a reciprocal basis,- though a quarter of each individual quota was still allocated on the basis prevailing before 1st September 1931. Previously quotas allocations were based on an average of imports over a certain base period, under this system the restrictions were held to be based on a method which was judged to conform with the principle of MFN. The report concluded that, so far, the record on the trade front and attempts at creating regional blocs were dismal. It concluded by endorsing the principles of the *Comité de Rapprochement* and indicated that it would subscribe to the *Comité* unless the Ministry for Foreign Affairs opposed it. This document is useful in the sense that it does portray a very realistic picture of the prospects for the Gold Bloc and suggests that prominent elements of the business community entertained few illusions.

An early paper examining the prospects of a trade agreement between Gold Bloc member states is a paper prepared by P.Stoppani, Director of the Economic Section of the League of Nations. This was prepared as a sort of *aide mémoire* and submitted along with a request for a meeting to discuss its contents with the then Finance Minister, Germain-

Martin.[129]

Stoppani's assessment must have made depressing reading. He rejected the idea of an international conference on tariffs, arguing that Roosevelt had been invested with exceptional authority and would be intent on using it, i.e., he would not abandon any of his discretionary armoury. Empire Preference countries and satellites were picking up, but the crisis in countries still on gold continued, whilst the disparity between relative price levels in the Gold Bloc and the rest of the world increased. To avoid a continued downturn in exports, industry and income from overseas, the Gold Bloc would need to rebuild links with the rest of the world. This should not prove too difficult for Belgium, but much more so for Switzerland. Stoppani argued that there were two options, viz., devaluation or deflation. He suggested that the latter course would be greatly facilitated by the reduction of import barriers. He rejected devaluation outright without even discussing its merits and demerits. However, he alluded to the paradox which seemed to have guided deflation. That is, continued protection whilst hoping for a lower price level, and increasing taxes whilst doing nothing to raise taxable output. He argued that these difficulties could be overcome if the will was there. A continuation of the present situation in the Gold Bloc whilst the rest of the world, comprising some two thirds of the economically developed world, recovered would be unsettling.[130]

Stoppani rejected a world economic conference arguing that it would be the least useful measure which could be undertaken. Though recognising that bilateral trade negotiations were understandable in depressed economic conditions and because of the MFN clause, this remained unsatisfactory as the tendency to balance trade bilaterally could only lead to a drop in overall trade. Stoppani argued that what is important is the volume and value of economic activity and that the net trade balance in itself is of secondary importance,[131] using as an illustration 1929 when aggregate French foreign trade amounted to 108 (?) *milliards* he pointed out that the trade deficit was some FRF 12 *milliards*, i.e., it

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[129] see M.F., B 32 323, 16/3/34, this paper is entitled: "*Idée d'un accord commercial provisoire et exceptionnel entre les pays de l'étalon or pour relever le volume et la valeur des changes commerciaux entre eux.*"

[130] Similar apprehensions have animated the European Commission since the UK floated sterling in September 1992 and British economic prospects consequently improved, whilst the remaining ERM members continued to suffer from recession.

[131] Very much as the British Chancellor of the Exchequer N. Lawson did in the latter half of the 1980s.

remains a small residual. At the same time capital invested abroad provided invisible earnings, the domestic fiscal base was stronger, and economic activity prospered. The invisible tourist balance on its own nearly sufficed to cover the trade deficit. Stoppani then went-on to point out that in 1934 the value of French trade will have fallen by a third of its 1929 level, and all the other domestic indicators were reversed. One would have thought that this was a manifest in favour of devaluation!

Stoppani pointed out that no country could therefore expect to find its way out of the depression on its own, nor through bilateral negotiations. What was needed was a large enough bloc of countries which could trade out of recession, within a system of multilateralised (triangular) trade clearing. In his view the only group which could begin the process was the Gold Bloc. The common desire to remain on gold could prove a sufficiently strong objective for governments to over-ride interest groups which might resist any move toward trade liberalisation. Stoppani suggested as a possibility, for illustrative purposes, an agreement for a ten month period which would aim to restore a volume of trade equal to that registered in 1931. This would be achieved by increasing quotas and similar measures, with possible variations for industry and agriculture. Stoppani wondered whether such a modest and temporary agreement aimed at increasing reciprocal trade between member states would prove possible given countries' respective economic conditions, intra-Bloc trade relations and relations with third parties. As it would turn-out even such a modest proposal proved illusive, and when a protocol was agreed in Bruxelles stipulating the "desirability" of a 10% increase in the volume of trade between signatory states, the base year adopted was 1933-34 a period during which intra-Bloc trade was way-down on the 1931 level.

A paper entitled: "*Résultats de mes conversations en Belgique, aux Pays-Bas, en Suisse et en Italie, relativement à la possibilité d'un accord économique entre les cinqs pays à étalon or de l'Europe Occidentale* (Avril 1934),"[132] bears a striking similarity to the structure of the *aide mémoire* by Stoppani which accompanied his letter to Germain-Martin requesting a meeting. We assume that the former paper, drafted in Geneva, was prepared by Stoppani. The paper lays down the attitude of the west European members of the Gold Bloc and the prospects for an economic agreement with the member states. It was the product of visits to the aforementioned member states and discussions held with senior

[132] Dated 10 May 1934, Geneva, which is appended to a letter from Boisanger to the Minister of Finance, M.F., 24/9/34, B 32 323.

policy-makers. Reasons adduced for increased co-operation are familiar ones, viz., attachment to the same monetary principles, the need for deflationary policy, and to promote trade amongst the member states. On the debit side the paper catalogues factors militating against such an agreement, viz., the importance of extra-Gold Bloc trade to many of its members, the disparity within the Gold Bloc between Belgian industrial prices and those of the other four member states; the argument that some French policy-makers were to make, that there seemed little point in extending quota concessions when many were not fully utilised, and doubt amongst member states that France would be willing to make agricultural concessions, which the Dutch would be keen-on. The doubts expressed in this regard were to prove well-founded, and this may well have been the reason for originally excluding Poland (as an agricultural producer) from the Geneva meeting. Though it was eventually agreed to invite the Poles, and they attended the Bruxelles meeting at their request.

The author of the document argued that the four states concerned were keen on reaching an agreement, and that this feeling was more pronounced now than in London, that these countries exhibited the same worries concerning monetary policy (i.e., the exchange rate) and that for historical (i.e., Italy, France and Belgium had already devalued), social and moral reasons these states wanted to avoid devaluation. The monetary problem was not technical or explicitly monetary (i.e., gold reserves remained high), but rather economic. Gold prices were too high within the Bloc. What could be done? The four countries which had been approached rejected devaluation, not least because it was still unclear when and at what level sterling and the dollar would stabilise.

The author argued that both budgetary and economic reasons called for continued deflation. The budgetary constraint suggested further reductions in government expenditure, whilst the economic argument for deflation hinged on export competitiveness. The paper takes the most orthodox view, without any consideration of the perverse nature of deflationary policy and without considering contra-cyclical budget stabilisers. The document argues with Cartesian logic that deflation must be total and not just confined to special groups, e.g., public sector employees, as this would tend to undermine the policy by creating a set of gainers and losers (of course in the longer term everybody is a loser under a policy of absolute deflation), however the paper argued that this process of deflation had to take place in the context of an upturn in economic activity "*déflation dans la reprise*"[133] - a contradiction in terms, which even Hayek would have recognised.[134] It should be possible the paper argued to use the opportunity afforded by falling prices within the Bloc to lower barriers and try and stimulate intra-Bloc trade, whilst freeing import controls, in order to reinforce the deflationary effort, particularly by allowing in non-Bloc trade. Of course, the very reason barriers were erected in the first place was to insulate domestic economies from the deflationary impact of falling prices!

The paper alluded to the paradox of an aggregate deflationary macro-economic stance married to a protectionist policy aimed at supporting the micro-economic interest of politically influential pressure groups, e.g., agriculture. This on a macro-level would tend to put a floor on wage deflation (see Reynaud; and Germain-Martin). However, as the author would recognise the French were the first to protect their agricultural interests, Italy did not want to jeopardise her surplus with the Bloc nor her extra-Bloc relations (*idem* for Belgium and the Netherlands in the latter regard), and Belgian industrial goods were too competitive, particularly compared to the most expensive market, viz., Switzerland.

A policy of market opening would prevent the erection of ever more protectionist barriers, exchange controls, restrictions imposed on tourism by nationals (which could be made effective by means of tight exchange controls) otherwise the Gold Bloc states might, despite themselves, be obliged to inflict self-reinforcing damage on one another. This is certainly a valid point and the Gold Bloc may at least have prevented a further deterioration in trade relations. As the earlier paper submitted as an *aide mémoire* to Germain-Martin this one argued that countries could not extract themselves from the present situation either individually or by means of bilateral relations, at least in the manner in which this was being currently practised. The paper argued that until then the format employed to secure economic and trade agreements was either a world economic conference or bilateral negotiations. Neither seemed capable of increasing international trade. World economic conferences were prey to too many economic interests, whilst bilaterals were fine in fair weather circumstances when the automatic extension of benefits (their multilateralisation) through MFN in a context in which trade was growing proved successful and less harmful

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[133] M.F., 24/9/34, B 32 323, op. cit., p.6.

[134] see Hayek, Prices and Production.

to producer interests. However, when world trade was falling year-on-year trade negotiators were obliged to look closely at bilateral balances and domestic economic conditions (which are a reflection of the same particular concerns in a context in which specific interest groups become more vocal in their demands for protection against specific markets). Nevertheless, as the author pointed out, balanced trade is synonymous with diminished trade.[135]

The paper argued that in the existing circumstances an increase in trade would only be possible as part of a concerted effort on the part of a like-minded group of states. Such a grouping would have to be wide enough to make liberalisation worthwhile and allow triangular compensation, which is the basis of efficiency gains derived from international trade. The problem of course would be that the group itself, namely the Gold Bloc, would never be large enough in itself and would not be sufficiently independent from extra-Bloc trade relations and have enough political clout and independence to ignore the potential threat of retaliation by extra-Bloc members, should they abandon MFN. According to the author the grouping should encompass states labouring under similar monetary and economic conditions. In such circumstances a desire to maintain the exchange rate (viz., gold parity) should force policy-makers to over-ride interest group pressure opposed to liberalisation.[136] However, this ignores the very short government cycle which militates against a long term view and the lack of strong government to resist the interest groups concerned, in the end as is so often the case the path of least resistance was taken, viz., attempting to muddle through,- which is what most non-conviction governments are wont to do.[137]

The author of the paper pointed out that till then the governments which were being sounded out, though favourable in principle to the sort of agreement being mooted were not willing to jeopardise relations with the UK, US and Germany. However, he argued that this was no longer such a worry because 1) tariffs were no longer so important, having been replaced by quotas and other non-tariff barriers (NTBs). There was therefore less of a case

[135] M.F., 24/9/34, B 32 323, op. cit., p.8.

[136] Quoting (M.F., 24/9/34, B 32 323, p.9, op. cit.) : *"On croit que le souci de maintenir la parité monétaire et d'opérer une déflation inévitable pourrait neutraliser les résistances particulières qui s'opposent toujours, à l'intérieur de chaque pays, aux sacrifices qui sont nécessaires pour rendre possible un accord international."*

[137] A contemporary example of this would be Italy, which is (was) locked-into a fixed exchange rate regime and sees its relative competitiveness decline year-by-year, but does nothing to tackle the underlying problems because of political immobilism.

for worrying about MFN, as quotas were less directly affected by the MFN clause; 2) quotas had tended to be accepted, though disliked, and had not on balance invited retaliation. In fact this is rather irrational because quotas are in fact more demonstrably inefficient, unfair and static forms of trade protection. Tariffs are far more in tune with a free market approach.

The author also pointed out that for matters relating to quotas governments enjoyed far more autonomy than with tariff matters, and could reach an agreement without having to secure parliamentary ratification,- tariffs being a fiscal matter. The UK and US would probably not retaliate in the circumstances, as a devaluation would be more likely to erode their competitive advantage. The anglo-saxons would also not want to undermine an agreement between the member states as it would help raise economic activity and could also act as a basis for third party negotiations.

However, the paper did allude to the difficulties and admit that the importance of intra-Bloc trade varied between member states. This was particularly the case for the Italians where intra-bloc exports in 1933 only represented 20.3% of total exports; and in the Netherlands where it represented 29.7%; whilst the share of intra-Bloc exports for the other member states was more considerable. It accounted for 32.8% of Switzerland's trade; 37% for France and 39.7% for Belgium. However, what is significant about these figures is the extent to which intra-Bloc trade exports had increased over the period 1929-33.[138] This was undoubtedly a result of these countries finding themselves priced-out of world markets (also world trade fell more sharply than Gold Bloc trade, see Appendix). The author of the paper argued that increased intra-Bloc exports were due to monetary depreciation by non-Bloc members and exchange controls. The figures do not include intra-Bloc colonial trade which would also undoubtedly show a growing degree of trade dependence between centre and colonial periphery.[139]

In the case of Italy its exports to Germany and the UK accounted for 20% of its total. This explained Italy's reluctant stance at the Bruxelles conference. The author reported that whilst the Italians and Dutch were not against reaching an agreement they did not want to jeopardize their trade relations with the UK, US and Germany. Another problem was that

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[138] see M.F., 24/9/34/, B 32 323 p.11, op. cit..

[139] see, "*Chiffres essentiels du commerce du bloc or*" (1935).

though prices in Italy, the Netherlands, France and Switzerland were fairly close, low Belgian industrial prices did pose a problem.

The author went-on to raise the point put to him by some French policy-makers who argued that it was unfair for certain countries to complain about France's protected agricultural market, when these countries had not even used up their total quota allocations. When states had expressed their willingness to extend larger industrial quotas, in return for reciprocal advantages, French representatives had turned these proposals down on the grounds that these concessions would be of little use as existing quotas had not been fully used and that as French prices were already too high there was little point in making concessions in return for a purely hypothetical trade advantage. The author seemed to have little to say in the way of rebuttal of this rather telling mercantilist argument (the answer of course would be to advocate devaluation). However, the author of the paper did state that these arguments were only adduced by particular interests, and that they merely attested to the need for an initiative aimed at liberalising trade in order to break this dead-lock. Such an initiative should take place in a context of falling prices so that goods would sell the better (the so-called "Pigou effect").

Nevertheless, the author reported that the four countries informally sounded remained sceptical whether France would be willing, and particularly parliament, to liberalise agricultural trade and that this had already been apparent in the past years. He suggested that there was little prospect of an accord unless France was willing to make concessions, however moderate, in this field. The author confirmed his own belief that Doumergue would be willing to pursue deflation and over-ride interest groups such as agriculture in an attempt to liberalise trade. However, Doumergue's supposedly authoritarian manner was to prove his downfall and his proposed constitutional reforms would be rejected.[140]

In a last section the author reviewed, from a national perspective, the attitudes of the several governments. The Belgians were apparently concerned that any agreement should not alienate the UK and Germany in particular, given the importance of these trading relationships. Nor was Belgium too keen on bringing Poland in, on the grounds that this would only complicate matters. The Belgians pointed out that Italy had originally wanted to invite Germany, but the Belgian authorities approached decided that it would be best to

[140] Doumergue's government lasted from February-November 1934.

confine the agreement to the west European Gold Bloc member states and that Germany and the UK might eventually tag along. The Belgians suggested that in order to avoid antagonising either the UK or Germany it would be a good idea to convene the meeting of the five Gold Bloc member state under the auspices of the sub-committee of the London Monetary and Economic Conference. This committee was chaired by Colijn. This method would ensure the tacit approval of Prime Minister MacDonald who, as Chairman of the Conference, would have to agree to its being reconvened.

Belgium recognised that despite its sound technical position, should any member state, and in particular France, abandon gold her position would become extremely difficult, despite its relatively low prices,- a product of its freer import policy and its policy aimed at maintaining a low cost of living. The fragility of the Bloc to any defections would be greater still in countries not enjoying Belgium's advantages.[141] Belgian industry realised that it could gain from a trade agreement, but realised that its very advantage could also constitute an impediment to reaching an accord. As we will see the Dutch expected as much.

The Dutch shared most of Belgium's preoccupations concerning a trade agreement. The Dutch would not profit from, and probably not agree to, an accord unless it included measures to increase their agricultural exports. Furthermore, the fact that the Dutch, and the Swiss too, held credit balances particularly against Germany meant that this would have to be taken into account. The Dutch therefore shared the Belgian view that an agreement should be reached within the confines of the World Economic Conference sub-committee which would act as the negotiating vehicle for the five Gold Bloc member states.

Italian policy-makers appeared more favourable than ever (according to the paper), and supportive of measures to increase trade and tourism and offset any deterioration which would result from a continuation of present policies. Despite Italy's greater reliance on extra-Bloc trade, it would remain the case that significant advantages could be derived if trade between Italy, France and Switzerland could return to its previous levels. However, Italians pointed out that Italy would be particularly interested in intra-Bloc agricultural exports and that there seemed little prospect of this being realised. Germany, though, remained perhaps Italy's most important single market and though it would not object to a policy which conformed to the gold standard, it still did not wish (as in the case of the

[141] see op.cit., M.F., 24/9/34, B 32 323, p.16.

Netherlands) to prejudice relations with the UK, the US and Germany.

The paper pointed out that the Swiss suffered from high prices and difficulties in implementing a policy of deflation. The Swiss remained favourable to an effort to promote trade revival and strengthen countries maintaining an orthodox monetary policy. Switzerland could happily accept an objective such as increasing trade to levels realised in 1931, as Swiss imports were at a level realised in that year and in some cases above such levels. However, this only demonstrates that the Swiss were looking at the problem with mercantilist eyes, as a means of bettering their trade balance. It is hard to imagine that other states would have accepted the unilateral concessions that this would imply. Within the Bloc disparity between Swiss (the highest) and Belgian (the lowest) industrial prices would constitute a problem.[142] Deflation had not worked well in Switzerland and remained a protracted process. The Swiss argued that with a policy of import liberalisation, in particular of agricultural commodities, and by adjusting the domestic system of minimum prices this could be achieved. The Swiss were therefore willing to endorse the general policy outlined in the author's paper. The author pointed out that the Swiss had, paradoxically, benefited in part from their high prices as countries had raised fewer obstacles to Swiss exports for this reason (however, this would not be of much use if you found yourself *de facto* priced out of the market). The Swiss therefore wanted a system to be devised, within the context of an intra-Gold Bloc trade agreement, which would not compromise the more liberal regime which their exports tended to enjoy. It was suggested that a system of preferential tariffs would be considered too hostile and that therefore some form of quota allocation in lieu would be necessary. However, the Swiss felt that this was hindered by the policy of countries like Italy which had so far strictly stuck to tariff policy and MFN, without resorting to quotas. However, the increased use of foreign exchange restrictions in Italy would have allowed the use of preferential foreign exchange allocations as a counter-part.

Tourism remained a concern for Switzerland. It would welcome measures aimed at preventing a worsening of the situation, such as joint measures to spark a recovery in this sector. However, should Germany by means of foreign exchange restrictions effectively block German tourist trade to Switzerland, Switzerland would be obliged by public opinion and the difficulties of its tourist industry to restrict Swiss tourists to holidaying at home

[142] One should recall that Switzerland, being a non-belligerent, had managed to retain its pre-war gold parity,- as did the Netherlands.

(setting aside coercive measures this could only mean foreign exchange restrictions, which would be tantamount to a suspension of gold convertibility). Switzerland's creditor position *vis-à-vis* Germany increased the difficulty of the relationship.

The Swiss recognised that whilst the technical monetary situation was sound (i.e., gold currency cover was high), it was necessary for purely economic reasons for her to bring her price level in line, particularly with those countries with devalued currencies. It was also recognised that should any country, and in particular France, abandon the gold standard the situation could become difficult for Switzerland. Therefore the Swiss would favour an accord, even if it should only be an agreement based on general principles and collaboration aimed at reassuring the public (viz., financial markets).

In an interview with B. de Jouvenel, reported in La Nation Belge on 18/9/34.[143] Francqui, the most authoritative Belgian financial authority and author of the 1926 stabilisation, suggested creating a Latin Economic Empire between the five Gold Bloc states and their colonies modelled on the UK Empire Preference system. Difficulties in establishing such a system were apparent though, even before the Geneva meeting. A report from the Minister for France in the Netherlands to the French Ministry for Foreign Affairs stated that the Dutch could not co-operate in the present circumstances in an effort to create a preferential tariff agreement particularly if this were to exclude the British and Germans.[144] The paper, dated 24/9/34, reports a denial, made to the Dutch press by the Dutch delegation to the Geneva conference, that the conference would lead to a political or military agreement. The author of the note, Vitrolles, pointed out that this was not news but that the *communiqué*, which must have been agreed with the government, was a pretext to go on to define the delegation's remit, which was confined to examining the possibility (underlined in the original) of co-operation in economic affairs.

An article in Le Temps prior to the Geneva meeting betrayed a certain degree of bullishness, which would appear unjustified. The article dated 21/8/34 pointed out that Gold Bloc exports to their colonies now accounted for 50% of their exports and that the Bloc might develop a financial role comparable to sterling.[145] However, French Minister of

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[143] see file at the *Ministère des Relations Extérieurs, supra.*

[144] see M.R.E., B *Questions Financières*, 57-7, *Bloc or* (1).

[145] see R.I.I.A., reel 301.

Commerce Lamoureux in a statement reported on 19/8/34 in Agence Economique alluded to the following difficult points.[146] Namely, MFN treatment which Gold Bloc countries had extended to countries with devalued currencies. Lamoureux argued that this would have to be renegotiated,- as we will see other member states were too afraid of possible retaliation to endorse this. Lamoureux goes on to identify as a further impediment, agricultural competition from fellow Gold Bloc member states and, finally, the different price levels prevailing in the Gold Bloc member states, i.e., intra-Bloc exchange rate purchasing power parity did not prevail.

THE GENEVA MEETING:

The first inter-governmental meeting of Gold Bloc states took place in Geneva on 24-25th September, 1934. Official sources allow us to follow the debate within this conclave and positions staked-out by various national delegations. These broadly reflected the original unofficial gathering of views submitted to the Minister of Finance under the heading, "*Résultats de mes conversations...*" Geneva, 10/5/34. At the meeting the French delegation reminded their interlocutors that agricultural interests could not be sacrificed, nevertheless the objective would be to mutually reduce quotas. It was agreed that committees would be set-up to examine means of increasing exchange, tourism, and transport as well as trade between the metropolitan authorities and colonies. The Belgian Minister for Foreign Affairs, Jaspar, who chaired the Geneva conference, was appointed as head of the Committee of Gold Bloc states. At the Geneva meeting it was suggested that quotas be brought into line with the level of French imports in 1931, however this was rejected on the grounds that these had been too high.

A letter from the French Ambassador in Bruxelles to the French Foreign Minister even suggested a union between France and Belgium as its security interests conformed with those of its economic well-being.[147] It is hard to imagine that such a proposal would have been attractive to the Flemish community. Bussière has argued that already the financial and

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[146] *Ministère des Finances B 32 323, Questions Monétaires: Trésor, Relations Internationales, Bloc or, 1933-35.*

[147] *"..., les alliances qui lui sont imposées par le souci de sa sécurité étant les mêmes que celles que son existence matérielle exige." in M.R.E., B Questions Financières, 57-7 Bloc or (1).*

trade relations between France and Belgium had begun to wane under the impact of depression (*vide supra*).

The Poles were not represented at the Geneva meeting, the conference being confined to contiguous west European Gold Bloc member states. Poland's exclusion can most probably be ascribed to fears that its large agricultural sector would only compound the difficulty of negotiating a trade agreement. Apparently the Swiss delegation was absent on the first day, the 24/9/34, of the meeting. The Poles, though, would be invited to the follow-on meeting to be held in Bruxelles.

The objectives of the conference to be held in Bruxelles would be achieved by means of bilateral negotiations and then whenever possible these would be multilateralised within the Bloc. This is confirmed in, "*Programme de procédure et directives générales*," dated 25 September 1934.[148] At Geneva it was also agreed to study the effect should Germany close itself off from the Bloc. The Bruxelles meeting was a product of the decision taken at Geneva to convene a meeting within one month with the aim of consolidating intra-Bloc monetary relations with measures aimed at fostering increased trade and tourism.[149] The paper drafted by Boisanger stated that he had urged Maxime-Robert, who was in Geneva, to press for a renewed commitment on the part of the Gold Bloc states in favour of their existing monetary constitutions. We know that both the Dutch and Italians were rather reticent to endorse such a commitment, but went along.

The following loosely paraphrases the official *communiqué* issued following the Geneva conference on 25/9/34. This renewed the signatory governments' (France, the Netherlands, Belgium, Italy, Luxemburg, and Switzerland) commitment to the free working of the gold standard, a commitment which the French government was particularly keen on seeing re-affirmed, and stated that the governments considered it one of the prerequisites of international economic and financial recovery. In order to foster recovery it would be necessary to increase international trade, but that in the present circumstances this could be best achieved amongst a group of geographically contiguous states, enjoying a similar monetary regime and economic policies. The *communiqué* reassured all third party governments that this initiative was in no-way directed against non-signatory governments

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148 in M.F., B 32 323.

149 see M.F., B 32 323, "*note pour le Ministre,*" from Boisanger dated 24/9/34.

and that the Gold Bloc would remain in close relations with non-participating states. It expressed the hope that non-member states might become party to this effort at economic revival.

In order to secure rapid results the signatory governments decided to appoint a committee composed of respective national delegates to study ways of developing economic and financial relations between signatory states. This committee should especially be concerned with two objectives 1) increasing trade relations 2) and the promotion of tourism and transport. The monetary side of this initiative having been dealt with by the agreement signed in Paris on 8/7/33 (*vide supra*). It was agreed that the commission would probably meet in Bruxelles during the first half of October.[150] A note appended to another copy of the *communiqué* sets out a more explicit agenda for the forthcoming meeting of the committee, to be chaired by the Belgian Foreign Minister Jaspar.[151] It stated that the governments which had signed the *communiqué* issued after the preparatory Geneva meeting should ask Jaspar to convene a meeting of the committee representing signatory states viz., France, Italy, the Netherlands, and Switzerland (note Poland was still excluded). It stressed that the committee should study ways of increasing trade, particularly in the field of metropolitan and colonial trade, as well as tourism and transport.

The method of negotiating these commercial agreements should be bilateral, and multilateralised (within the Bloc) to interested third parties. This method still smacks of mercantilism, though it makes trade negotiations less complex, and is the formula adopted within the GATT. The committee was also tasked with encouraging consultation between concerned producer groups. The committee would also be entrusted with monitoring progress made. In matters concerning tourism it would be abilitated to make suggestions to governments which might assist in the development of tourism. The committee would also study the effects of a break in trade relations with a non-participant state (viz., Germany).

[150] see "*note*" addressed to the Minister of Finance by Boisanger, *Directeur du Mouvement Général des Fonds*, M.F., B 32 323.

[151] see, "*Programme de procédure et Directives Générales*," appended to, "*communiqué adopté à Genève 25/9/34*," M.F., B 32 323.

PREPARING THE BRUXELLES MEETING:

A preparatory meeting ahead of the Bruxelles conference was held at the Ministry of Commerce, and attended by most of the Bruxelles team of French delegates. The minutes of this meeting set out clearly what would be the French position in Bruxelles.[152] These minutes are summarised for the Minister of Finance in a paper from Boisanger, dated 12/10/34.[153]

We shall first examine Boisanger's paper, which takes a broad political view. Boisanger pointed out how limited were the concessions which the French government was willing to put on the table in Bruxelles and that this could have serious monetary consequences for Belgium (i.e., devaluation). Boisanger alluded to a report submitted by Maxime-Robert on a recent visit to Bruxelles (this report was forwarded by Boisanger to the Minister on 9/10/34), as well as Boisanger's own contacts which suggested that the probable failure of the Gold Bloc conference (*l'échec probable*) to be held in Bruxelles could well encourage the Belgian lobby which favoured devaluation and might prompt a change of policy on the question by senior members of the Belgian cabinet. Boisanger's paper clearly demonstrates that one of the most senior Treasury officials was well aware of the limited scope of the Bruxelles conference and the fragility of the Gold Bloc. The Belgian problem seems to have been a constant worry. Boisanger alluded to Maxime-Robert's report which stated that though devaluation was not at the forefront of the political agenda it might well emerge if a solution to the budgetary situation could not be found, interest rates lowered and greater access to foreign markets secured.

Boisanger classifies the meagre fare which the French government was willing to put on the table in Bruxelles into three separate rubrics. 1) On agricultural quotas affecting Gold Bloc member states, it would offer a six month freeze, in return for similar concessions (*avantages corrélatifs*); 2) as concerned quotas on industrial goods France could offer the unused portions of quotas; 3) study ways of palliating an eventual breakdown of commercial relations with Germany. The Gold Bloc states could be given preferential access for goods

[152] see, "*Compte rendu de la Commission réunie à la Direction des Accords Commerciaux le 29 Septembre 1934*," M.F., B 32 323.

[153] M.F., B 32 323.

currently bought in Germany and examine means whereby those goods now sold in Germany could find an outlet within the Bloc.

Looking at the minutes of the meeting (which gathered: Bonnefou Craponne, Director of Commercial Agreements; de la Baume, deputy-Director for Commercial Relations at the Ministry for Foreign Affairs; Devinat, *Directeur de l'Office de Compensation*; Lecuyer, Customs official at the Ministry of Finance; Rueff, assistant-Director to the Treasury department at the Ministry of Finance; Maxime-Robert, *Inspecteur des Finances* (Public Auditor); The Director of the Tourist Office; Weill, *Ingénieur des Mines*; Joffet, from the Ministry of Agriculture; Toussaint, from the Department for Commercial Agreements. What is immediately apparent is that there is still no mention of Poland. The decision to invite Poland was obviously made late in the day. Monetary questions were to be excluded from the agenda, having been dealt with by the 8th July agreement. The agenda should cover the question of increasing trade relations, promoting tourism and be concerned with railway, maritime and air transport.

Reviewing the Geneva meeting the minutes state that import quotas be raised to trade levels recorded in 1931. This had been suggested as a base year, but was rejected by the French Minister of Commerce because of the high level of French imports recorded in that year and because of the economic diversity of the Gold Bloc member states which precluded any such multilateral process of liberalisation. Therefore, a bilateral approach would be adopted (this met with unanimous approval), any agreement could then be widened to include other Gold Bloc states concerned. This clearly displays a continued mercantilist approach, in a sense, inevitable in a downturn as the clamouring interest groups affected by the depression became more shrill.

The committee decided that France could not offer preferential quota concessions to Gold Bloc member states because of pre-existing commercial agreements, such as that with the UK. This stipulated that the UK would be entitled to a fixed proportion of any French quotas. This meant that no concessions could be made outside existing total global quotas. This effectively meant that France would not increase her quotas and that at least total potential French imports would not increase whatever was agreed in Bruxelles. The committee suggested a freeze on French agricultural quotas in favour of Gold Bloc states. This would be for six months, other member states would have to offer compensatory concessions,[154] whilst Switzerland could offer a similar freeze in return. Belgium, the Netherlands, and Italy could not offer a similar freeze as they had not imposed agricultural import quotas.

In industrial goods the committee argued that a *de facto* freeze existed. That it would be impossible to increase quotas without having to extend these benefits to third parties and that therefore it would only be possible to offer Gold Bloc states the unused portion of existing quotas.

The effect of a withdrawal of Germany from trade relations with the Gold Bloc would also be studied under the terms reported by Boisanger (*vide supra*). Tourism could be encouraged through greater exchange of information and any development of tourism would be in France's favour given its comparative advantage. In the field of transport measures could be undertaken to ease the transit of Italian agricultural produce towards the UK and transport between Gold Bloc members should be improved. On the colonial question France would listen to the views expressed by other Gold Bloc states, excepting the question of labour which particularly concerned Italy.[155] The committee agreed to meet again on 15th October at 15hrs.

As can be appreciated from the above the proposed concessions which France was willing to make were meagre indeed, the trade proposals did not involve any increase in aggregate French import quotas and other measures appear to boil down to exchanging tourist brochures and railway timetables!

On the 11th October, ahead of the Bruxelles conference, the French Commercial Attaché in Bruxelles warned that a failure of the conference would mean that the Belgians would most likely devalue and drift into being a satellite currency of the sterling area.[156] This largely substantiated Boisanger's warning (*vide supra*).

A letter from the Belgian Embassy to Laval, the French Foreign Minister, notified the French government of the Bruxelles conference dates, the 19th and 20th October, to be

[154] If one of the options was to offer to freeze quotas, i.e., not increase them in return for which other member states were to offer concessions, clearly the initiative lacked ambition!

[155] Presumably this refers to immigrant Italian labour.

[156] "*Je répète que la dévaluation me semble inévitable. Rien ne la justifie techniquement mais tout la prépare économiquement.*" It concludes, "*Déçue dans ses espoirs inconsidérés, isolée et de situation précaire, attirée par la grandeur de l'Empire, la Belgique, par tous les moyens, tendra à devenir un sous-dominion anglais.*" (see M.R.E., B *Questions Financières, Bloc or (1), document 126, pp.128-9).*

held at the Belgian Foreign Ministry. This letter included a list of national delegates and stipulated that the Italian government had not formally appointed a delegation. The letter was sent on 15th October 1934.[157] The latter is a clear signal of the Italian government's less than forthcoming attitude towards this initiative. There was still no mention of Polish participation.

The letter suggested that Stoppani, who had attended the Geneva conference, be present in Bruxelles both because of his expertise but also because in his capacity as Director of the Economic section of the League of Nations (*Directeur de la Section des Relations Economiques*) he would provide a useful link with third party governments. In the letter the Belgian Embassy pointed out that the third question on the agenda would be the matter of colonial and metropolitan trade. As we have seen the French had not expressed an opinion on this matter at their preparatory meeting at the Ministry of Commerce on 29/9/34. The fifth question related to the mooted international agreement dealing with commercial information (*propagande commerciale*) this appears to have been an initiative originating from the Secretary General of the League of Nations.

Appended to this letter is what appears to be a proposed draft (*avant-propos*) conference *communiqué*. It subscribes to the general objective of promoting international trade and economic recovery. The aim would be to increase exports between signatories by 10-15% within the first year. This would be achieved by means of a collective effort. This was a more ambitious target than that which the French delegation appeared willing to endorse. The rest of the paper endorsed the method of bilateral negotiations and did not differ from other proposals. However, the last point (7) stipulated that before the expiry of this first step a new target for the expansion of trade relations be set and agreements be extended to third parties.

Italy's attitude before the meeting in Bruxelles, on 20th October, is captured in notes at the Ministry for External Relations and at the Ministry of Finance.[158] The Italians were keen on bilateral accords which they felt would be less likely to undermine their creditor position *vis-à-vis* Gold Bloc countries, with the exception of Switzerland. The facts appear at odds with some of the reports examined, whilst the argument in favour of a bilateral

[157] M.F., B 32 323.

[158] M.R.E., B *Questions Financières*; M.F., B 32 323.

format as less likely to undermine Italy's creditor position also appears difficult to understand. If we look at the report prepared by Stoppani's office at the League of Nations it indicates that Italy had indeed run a surplus on trade account against all Gold Bloc member states since 1930.[159] It also ran a surplus in 1933 against all Gold Bloc member states excepting the Belgo-Luxemburg Union, whilst with Switzerland it actually ran its largest surplus within the Gold Bloc.

As to the Italian view that a bilateral format would be more appropriate in guaranteeing Italy's interests it may be that the improvement in Italy's trade balance both against the Gold Bloc and the rest of the world in the period 1928-34 was due to increased tariff protection and/or exchange rationing. Certainly imports fell somewhat faster than exports,- of course the drop in value terms of aggregate trade (imports and exports) to some one third of its previous levels meant that the nominal figures for outstanding net trade balances diminished proportionally. It may be that Italy felt that multilateral liberalisation, instead of benefiting it, risked raising its total nominal trade deficit if concessions were extended outside the Bloc and that within the Bloc these could erode its aggregate surplus balance against the Bloc. However, in bilateral negotiations Italy could find itself presented with demands for better balanced trade. Switzerland might have pressed for this as Italy ran a surplus of Lira 213 million against Switzerland in 1933, compared to a total surplus against the Gold Bloc of Lira 227 million and we know that Switzerland had expressed its satisfaction with the concept of increasing trade with the Gold Bloc which it saw as a means of redressing its deficit with the bloc. Of course Italy might well have preferred a set of bilateral negotiations as a means of effectively burying the initiative which would get bogged down in technical details and horse trading.

The Italians were particularly keen not to offend non-member states.[160] A far higher proportion of Italy's export trade was conducted outside the Gold Bloc. The Italians appear to have been particularly concerned with the prospect of British retaliation should any agreements reached infringe MFN.[161] According to papers at the M.R.E. (*ibid.*) the

[159] "*Chiffres Essentiels du Commerce des Pays du Bloc-Or entre eux, ainsi qu'avec l'Allemagne, le Royaume-Uni et les Etats-Unis,*" dated March 1935, L.N..

[160] see letter dated 24 October 1934, from the Minister for Foreign Affairs to the Minister of Finance, M.R.E., B 32 323.

[161] see note from French Financial Attaché in Rome dated 24 October 1934, M.F., B 32 323.

Italians were using the application by Poland to be party to the meetings in Bruxelles as a pretext for postponing the conference. As we have seen the Italians had not formally appointed a delegate on the 15th October,- four days before the conference was to meet. However, the French argued that postponement would undermine confidence and that the issue of Poland's participation was a false pretext as it was already at the top of the planned agenda. The Italian government agreed to send one delegate and wanted the talks to remain technical. The French were keen that the Italians send a higher profile delegation in order to negotiate fully.

Studying press articles we find the Financial News on 29 September 1934[162] opining that France was not altogether keen on trade liberalisation as it was worried about its possible impact on its policy of agricultural protection,- justifiably so it would appear from the note at the Ministry of Finance which warned that the Dutch would want some concessions in this field.[163] The Financial News argued that France did not want to make tariff concessions to Belgium, Switzerland and Italy as it ran a favourable balance with the three. The article points out that MFN could act as an impediment to trade liberalisation. An article in *Le Temps*, though, published on 19th October just before the conference,[164] argued that the way around MFN might be to give mutual concessions in goods which both countries party to bilateral negotiations effectively tended to monopolise - this procedure agreed at Geneva would be adopted.[165] The article, though, went on to argue against the exclusion of other nations. France remained worried that Polish participation, with its substantial agricultural interest, would make negotiations that much harder.[166]

The Dutch appear to have been divided as to the merits of further economic co-operation. A note from the Minister for Foreign Affairs to the Minister of Finance dated 30 October points out that though the Dutch Minister of Finance was keen on re-establishing

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[162] R.I.I.A. reel 301.

[163] see, *"Résultats de mes conversations..."* 10/5/34, *vide supra*.

[164] R.I.I.A. reel 301.

[165] An approach adopted in the Kennedy round of trade negotiations.

[166] see note from French Financial Attaché in Rome dated 24 October 1934, M.F., B 32 323.

trade,[167] the Minister for Economic Affairs was less enthusiastic for fear of closing or prejudicing trade relations with Germany as a result of retaliation. A note dated 24 September 1934 from the French Minister in the Netherlands to the Minister of Finance indicated that the Dutch would refuse to enter into a commercial agreement which would exclude from its preferential provisions the UK and Germany, in particular.[168]

The Belgian hosts sent a high-powered delegation to the conference being represented by H.Jaspar, the Foreign Minister, G.Sap the Minister of Finance, F. van Cauwalaert the Minister of Agriculture and Post, Telegraph and Telephone, and P. van Zeeland a member of the Council of Ministers and future Prime Minister charged with effecting Belgium's devaluation.

The French delegation consisted of Lamoureux, Minister of Commerce and Industry, Bonnefou-Craponne, Director for Commercial Agreements at the Ministry of Commerce and Industry, Coulondre assistant-Director of Political and Commercial Affairs at the Foreign Ministry, Rueff assistant-Director to the Treasury Department (*Mouvement Général des Fonds*) at the Ministry of Finance, accompanied by a Customs Administrator (*Administrateur des Douanes*), Billet assistant-Director at the Ministry of Agriculture, and Lipmann *Inspecteur Général des Ponts-et-Chaussées* who was also *Directeur du Personnel au Ministère des Travaux Publics* (Personnel Director at the Ministry of Public Works).

Despite efforts by the French government the Italians only sent one delegate: Asquini, assistant secretary of State at the Ministry for Corporations. The French government had apparently pressed for the remit of the Italian delegate (s) to be as wide as possible in order to allow for constructive negotiations.[169] A confidential report stated that the Italians were expected to adopt a very reserved attitude at the Bruxelles meeting, whilst Holland was not expected to be too keen either.[170]

The Luxemburg government was represented by Bech, Minister of State and President of the Government as well as A.Wehrer state councillor (*Conseiller du Gouvernement*). The Netherlands were represented by Steenbergh, Minister for Economic Affairs and Lamping,

[167] M.F., B 32 323.

[168] M.F., B 32 323.

[169] see document 149 M.R.E, B *Questions Financières*,- names of delegates come from the same box file.

[170] see M.R.E., B *Questions Financières*, p.152 in file, op.cit..

Director for Commercial Agreements, and the possible participation of other delegates.

The Swiss delegation was headed by Stucki.[171]

On the eve of the conference C.-J.Gignoux, in an article published in, La Journée Industrielle, 19 October 1934,[172] pointed out one of the major stumbling blocs impeding closer intra-Bloc trade, and which Lamoureux had also identified (*vide supra*), namely, the problem posed by the MFN clause. A similar sentiment, concerning the use of MFN, was echoed in Le Soir of 20 October 1934 in which it was argued that MFN was a hindrance to trade revival, particularly within regional groupings and that it was only a fair weather measure. This view is also expressed in the note: "*Résultats de mes conversations...*".[173]

In fact unless trade liberalisation is embraced by the major trade groupings, the MFN clause can have a very negative impact on the process of trade liberalisation setting up a prisoners' dilemma situation of the sort, "if I liberalise unilaterally will he reciprocate?" Despite the theoretical model which proves that unilateral liberalisation would on the whole be advantageous it completely ignores the very real problem of interest groups and political constituencies which politicians are answerable to. That is, "policy has to be implemented and understood within a complex economic and political nexus which represents a mingling of history, general and group interests, collective identity, electoral expediency and economic criteria," - this methodology is at the core of our thesis. The gains from an MFN approach are also dependent on the premise underlying liberal trade theory, viz., the flexibility and malleability of factors of production which derives from its essentially individualist and atomistic philosophical and methodological foundations.

As we shall see MFN did constitute a barrier to liberalise intra-Bloc trade, as some argued MFN was fine as a fair weather measure but could, in difficult circumstances, prove a real impediment to trade liberalisation, contrary to the liberal world-view so ardently promoted by US interests in the post-war world e.g., Cordell Hull who arguably fabricated a version of inter-war history, viz., that protectionism was one of the root causes of the

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[171] source: letter from Belgian Embassy to the French Foreign Minister, Laval, 15/10/34, M.F., B 32 323.

[172] Quoting Gignoux, "*Nous entendons dire ces jours-ci que l'usage de la clause inconditionelle de la nation la plus favorisée empêche toute orientation préférentielle de notre politique contractuelle, alors que le resserrement du bloc or présuppose cette orientation. L'occasion sera peut-être bonne de se demander une fois pour toutes si l'usage de la clause dont-il s'agit reste concevable, dans un monde où la disparité des potentiels de concurrence est complète.*" article in La Journée Industrielle, 19/10/34, file M.F., B 32 323.

[173] *op.cit.*, Geneva 10/5/34.

depression, whilst in fact it was but a protective reaction. The former thesis was promoted to secure a liberal world trade regime which was obviously in the interests of US capital. US pressure on the UK to liberalise its economy and payments system in 1946-7 as a precondition for a substantial loan proved disastrous, though one should add that Cordell Hull's trade liberalisation initiative of 1934 was based on a Reciprocal Trade Agreement.

At the conference the Belgians apparently suggested increasing trade between member states by 15%.[174] France's objectives, according to this source, were a six month freeze on agricultural quotas affecting wine and vegetables and that preferential treatment be applied in the re-allocation of existing unused quotas which would be the mechanism whereby trade would be expanded within the Bloc! It also suggested that a commercial charter be established in order to avoid an escalation of trade restrictions. However, it was not at all optimistic on the prospect for multilateral accords. It appears from the files at the Foreign Ministry that the idea of some form of extensive commercial collaboration had been mooted in London but that this had not been implemented for political reasons and particularly because the Italians wished to secure German participation. It was thought that such collaboration would allow these countries to better stand-up against the anglo-saxons.[175]

A note from the Minister for Foreign Affairs to the Minister of Finance aimed at giving a full background documentation to the Bruxelles conference referred to the contact established between the French Commercial Attaché in Rome and MM. Jung and Asquini concerning the forthcoming conference in order to ensure that the Italian delegation to the Bruxelles conference would have a wide enough remit so that constructive negotiations could be conducted in Bruxelles. Asquini, Italy's sole delegate to the conference, told the French Commercial Attaché, Sanguinetti, that like the Finance Minister he had not altered his views since the London Conference and remained in favour of the Gold Bloc policy. However, he warned that he did not feel that the present climate was conducive to a project which could only be realised by means of bilateral negotiations and quota concessions.[176] Not only did Gold Bloc trade only account for 20% of Italy's exports, but Italy enjoyed a creditor position

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[174] see document p.153, M.R.E., B *Questions Financières.*

[175] see document 178 at M.R.E., *Note pour le Ministre* from *Direction Politique et Commerciale.*

[176] "*..., que le moment actuel se prête mal à des réalisations qui, d'après lui, ne pourraient être recherchées que dans des concessions bilatérales concernant les contingents.*" see M.R.E., document 174.

vis-à-vis the bloc (*elle est créancière vis-à-vis d'eux*) excepting Switzerland,[177] and the latter fact would have to be taken into account by the Italian government when considering any proposals aimed at restoring equilibrium in the exchanges as well those aimed at increasing the volume of trade. Asquini also underlined the necessity of not alienating any third parties not participating in the conference.[178]

An article in Sole[179] confirms the Italians' fear of a British reaction to any derogation from MFN. The article also suggested that if the Conference were to fail the Dutch might consider a bilateral agreement with the Belgians,- though that does not necessarily square with the French paper which reported the Dutch opinion that the conference was a means for the Belgians to find trade advantages. The article also worried that last-minute Polish participation would complicate matters, particularly as it was predominantly an agricultural nation.[180]

A paper at the Ministry for Foreign Affairs noted that since the London Conference the economic situation had actually deteriorated in the countries which had had so far the least success in deflating. These were, the Netherlands, Switzerland, and France, whilst Italy and particularly Belgium are identified as having been more successful at deflation.[181] This document went on to suggest that to assist deflation, imports should be increased, but from within the five Gold Bloc states. The stimulus that this would give to trade would offset the impact of deflationary policy. An article in Le Soir expressed a similar view.[182]

Many of the preparatory documents at the Ministry for Foreign Affairs stressed the

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[177] source: M.F., B 32 323, note from Minister of Foreign Affairs to Minister of Finance dated 24/10/34, n.2909.

[178] see M.R.E., B *Questions Financières, Bloc or* (2), p.46.

[179] Quoted by Reynaud in a paper in the files of the Ministry for Foreign Affairs, p. 86, B *Questions Financières, Bloc or* (2).

[180] In this period the agricultural sector in all west European Gold Bloc states accounted for a far higher proportion of GDP, but more importantly employment, than it does today.

[181] "*Depuis, la situation économique des pays à l'étalon or s'est aggravée, dans une moindre mesure dans les pays où une politique de déflation a pu être poussée plus rapidement, en Italie et surtout en Belgique, plus sérieusement au contraire en Hollande, en Suisse et en France.*" see M.R.E., B *Questions Financières*, p.179. This by no means leads to the conclusion that deflation should be pursued as a cure, rather that the worse economic performance of those countries with the least success at deflating their economies, was due to difficulties of adjustment, and that the answer should be to abandon such policy.

[182] Le Soir, 20 October 1934.

need to encourage cross-border trade, and tourism by encouraging exchanges of information.

A paper from the French Legation in the Netherlands,[183] examining the Dutch position ahead of the Bruxelles conference, argued that the Dutch Ministry of Foreign Affairs was keen to re-establish commercial links, but that the Minister of Commerce was aware of realities and fearful of closing-off the German market leading to a tariff war or prohibitions. One of the architects of this policy had told the French representative, de Vitrolles, that the Dutch would be obliged to sell to the Germans even if they did not pay, as a halt to Dutch exports to Germany would have such an impact on share prices (*cours intérieurs*) that it could trigger a crisis which would affect the whole country.[184] The Dutch considered bilateral negotiations as the best way of progressing. However, the perception in Holland was that the conference was a means for the Belgians to secure economic advantages. The paper concluded with a secret postscript indicating that Belgium's economic and financial situation was becoming more and more serious. This confirmed Maxime-Robert and Boisanger's opinion.[185]

However, the paper went on to state that Belgium's attempt to use the threat of devaluation and the prospect of joining the sterling bloc as leverage had not proved successful and permission to issue a loan on the Amsterdam exchange had recently been refused.[186] The report also pointed out that the recent contested case of a Dutch rail order was bound to go to Poland, whatever the French bid, because of the concessions offered by the Poles on Dutch exports as a counter-part to the deal. Using this illustration he argued that the Dutch remained rather cynical about the prospects of any attempt at securing a multilateral approach to liberalisation and that the sought after goal would have to be achieved through tough bilateral negotiations. The French Minister in the Hague had also spoken to Lamping, on his return from Bruxelles, who had stated that the Franco-Belgian scheme, as it stood, was nothing more than a wish and would be dependent upon individual agreements. Lamping's view was that the Belgians would use the threat of devaluation to secure unilateral advantages. However, he thought the conference would prove a useful means of constituting

[183] see document 190, M.R.E., B *Questions Financières*.

[184] see copy of report forwarded to Finance Minister, on 30/10/34, M.F., B 32 323.

[185] see note to Finance Minister dated 12/10/34, M.F. B 32 323, *vide supra*.

[186] see copy of report forwarded on 30/10/34 to the Minister of Finance, M.F., B 32 323.

between producers, as opposed to governments, a system of cartels similar to the policy which had been practised under Loucheur in the past. Poland's participation would put the conferees in the invidious situation of invoking specific interests, viz., agriculture, which contradicted the principles governing the initiative,- though it is hard to see that the initiative was approached, in any way, in a liberal free trade spirit.

The papers at the Foreign Ministry indicate that the Dutch were unlikely to prove pliant at the conference as Gold Bloc member states only accounted for 28% of her exports, whilst Germany alone absorbed 22% of her exports, and the Netherlands was also concerned about the UK.[187]

It was feared that the UK would ask for any tariff concessions to be reciprocated under MFN. It was argued that progress could only therefore be made by means of quota concessions. However, Holland had been reducing its quotas and to increase quota allocations in favour of Gold Bloc states would mean reducing existing non-Gold Bloc member states' allocations, which was highly unlikely.[188] To further complicate matters, because of the commercial agreement between France and the UK, ratified on 1st July 1934, France had agreed to extend any quota concessions made to the UK. This was confirmed by the French Minister of Commerce, Lamoureux, in an interview.[189]

The heads of the conference delegations were the following, Asquini (Italy), Stucki (Switzerland), Lamoureux (France), Jaspar (Belgium), Bech (Luxemburg), Steenberghe (the Netherlands), and Dolezal and Muhlstein (Poland).

The Swiss worried about their deficit against other Gold Bloc countries, whilst the Dutch and Italians apparently expressed reserves about the need to re-affirm a commitment to gold parities. Boisanger urged Maxime-Robert, then in Geneva, to draft a *communiqué* which would incorporate such a renewed commitment to existing parities.[190]

Stucki, the Swiss delegate, argued that countries without quotas,- concessions on

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[187] see M.R.E.documents 192-193.

[188] see document 193-194, M.R.E., B *Questions Financières.*

[189] "*C'est ainsi que les accords anglo-français stipulent que chaque fois qu'un contingent d'importation en France est augmenté en faveur d'un pays quelconque, le contingent anglais doit l'être également.*" (p.17, interview given on 22 October 1934, M.R.E., *Relations Commerciales, B Questions Financières, 57-7, Bloc or (2).*

[190] see *note pour le Ministre* 24/9/34, M.F..

residual quota allocations being the principal means decided on to raise intra-Bloc trade because of the difficulty of agreeing to any other means, and no doubt because of the lack of ambition of the programme,- would have to make equivalent concessions.[191]

A note marked very urgent from the Minister for Foreign Affairs to the Minister of Finance, dated 20/10/34,[192] reporting on the first day of the Bruxelles conference highlights some of the difficulties. The most unexpected was the reluctance of both the Italian and Dutch delegates to endorse the idea of issuing a new *communiqué* re-affirming their commitment to the existing gold parities. However, on the insistence of Lamoureux with the support of Jaspar, both delegates agreed to refer the matter to their respective governments and to have an answer by the next day.

On trade matters the French delegation was able to submit for discussion its amendment to the Belgian proposals which had been discussed in Paris. This no doubt refers to the "*avant-propos*" appended to the letter from the Belgian Embassy to the Minister for Foreign Affairs, Laval (*vide supra*).

The Swiss opposed across the board reductions in protective barriers as this would merely increase Switzerland's total trade deficit,- therefore a bilateral format for trade concessions should be adopted. The Swiss also pointed to the difficulty which quota concessions as a method of extending trade concessions imposed, as those countries without quotas were not able to reciprocate.

The committee did not press these issues any further given the very significant differences in positions adopted. It was agreed that a sub-committee be created which would study the Belgian and French proposals as well as an Italian proposal which would confine negotiations to a bilateral format without setting any formal targets. It is clear from the tone of this paper that little could already be expected to issue from this. However, the French delegation was apparently determined to oppose any *communiqué* which might suggest that the conference was a failure and which would disappoint the expectations which certain governments had placed on the outcome of negotiations.

It is interesting to note in an article published in Agence Economique et Financière on 20/10/34, after the first day of the conference, the reporter stating that the French and

[191] see papers at M.R.E., B *Questions Financières*.

[192] M.F., B 32 323.

Belgian delegations were the only ones which appeared prepared for the negotiations, whilst an internal French Foreign Ministry paper circulated to Embassies following the Conference stated that the Belgian preparations were hopeless and that the French had had essentially to take-over. The article states that Jaspar had proposed a 15% increase in the volume of trade, which as we have seen was incorporated in the "*avant-propos*" forwarded by the Belgian Embassy in Paris. The article pointed out that the Gold Bloc aimed to facilitate the process of price deflation by stimulating trade, whilst at the same time the increased volume of business should offset budgetary short-falls resulting from the policy of deflation.

The article pointed out that once bilateral agreements had been reached both at an official level and by interested parties, which governments would encourage to get together, the bids and offers would be brought together. This would allow a figure for a percentage increase in trade to be calculated which in turn could be applied as a benchmark for imports between countries. This idea of establishing a bilateral norm indicates the extent to which any notion of triangular trade and clearing was being abandoned.

However, the conference did finally issue a statement re-affirming its commitment to gold and that a 10% increase in trade was "desirable." Using the period 1933 to 1934 as a base which could by no stretch of the imagination be considered ambitious,- the previously suggested base period had been 1931. Figures in the League of Nations report, "*Chiffres essentiels du commerce des pays du bloc-or*," indicated that intra-Gold Bloc imports in 1931 in millions of Swiss francs were 4,874 millions; exports 4,694 millions; in 1933 imports were 2,922 millions; and exports 2,996 millions. As these figures are expressed in value terms they over-estimate the decline, nevertheless they are indicative. It was also agreed that the seven countries would create a *Commission Générale* which would meet periodically. The French were apparently quite pleased at the outcome given Italy's early negative attitude and an impression, recorded here, that the Belgians had been too pushy.

I believe they originally proposed an increase in trade of 20%,- how does one reconcile this with the view sometimes expressed that the Belgians had not prepared the conference properly because, as Mouré (1991) argues, they were not very keen? As we have seen Bussière (1988) took a contrary view.

A paper at the Ministry of Finance reveals that the French Foreign Minister had instructed the French Ambassador in London to reassure, if necessary,- which did not seem to be the case given press comments,- the British government ahead of the Bruxelles meeting of Gold Bloc states. The note is dated 5th October[193] apparently the British Ambassador in Geneva had already been approached.

On the day the conference opened the Financial News reported (20/10/34) that the Bank of France had apparently given assistance to Belgium on a couple of occasions and in one instance to a Dutch banking group.[194] The *Gazette* argued that the Gold Bloc which, till then had been a creation of journalists and amounted to nothing of any substance, would have to take some concrete form.[195] Jaspar, the Belgian Foreign Minister, who chaired the conference, argued that it was only a "*Commission de Travail*," most probably to defuse any high hopes. *La Meuse* reported that the *Commission* decided to create a set of sub-committees which would respectively study, means of increasing commercial information within the Gold Bloc; co-operation in the field of tourism and transports.[196] The Manchester Guardian (20 October) reported that the declarations on the first day of the conference were in favour of gold and existing parities and the need to pursue bilateral negotiations between Gold Bloc countries in order to increase trade by 10% in a maximum period of one year.[197]

An analysis of records at the Ministry for Foreign Affairs can give us an impression of the positions of the delegations in Bruxelles. Lamoureux had suggested that the Gold Bloc should approach Germany, the UK and the US to ask them to allow derogations from MFN. Other delegations rejected this for fear of souring relations with these states. Those opposed to asking for derogations from MFN pointed-out that those states consulted would just say no and that anyway the UK had not asked for permission to set-up the Ottawa system (which encapsulates the problem for the Gold Bloc namely that the UK did not have to). Despite this the UK had opposed Ouchy. The French argued that Ottawa would be a good precedent to secure an agreement, although what it does point to is the relative asymmetry and leverage

[193] M.F., B 32 323.

[194] R.I.I.A., reel 301, 20 October 1934.

[195] 20 October 1934, M.R.E., B *Questions Financières*.

[196] 20 October, M.R.E., B *Questions Financières*.

[197] Both in R.I.I.A., reel 301; see also *Le Temps*, 21 October.

of both rival groupings. However, it was decided that the matter would be discussed later.[198]

The Swiss delegate, Stucki, argued that the Swiss were in a difficult position as they a ran a deficit with all Gold Bloc states and if there were to be across the board reductions this would just lead to an increase in the Swiss trade deficit,[199] this suggests a desire for bilateral trade-offs or unilateral concessions from other members. Italy pointed-out that it had few quotas, "how could it then reciprocate in such circumstances?" Tariffs could not be relaxed because of MFN and in any case this would benefit, without any reciprocity, countries such as Germany and Japan.

Steenberghe, for the Netherlands, argued that the Dutch situation was similar to the Swiss,[200] hence the need for bilateral concessions, and pointed-out that 80% of Dutch trade was conducted outside the Gold Bloc.

France remained insistent that a commitment to gold was a *sine qua non* of further co-operation. An informal link between Gold Bloc states was created. This would be maintained through the chairman of the meeting, Jaspar. However, it was understood that this should not be publicised,[201] though, of course, Jaspar was to preside the *Commission Général* of the Gold Bloc member states.

The Financial News commenting on 22 October 1934 on the outcome of the conference stated that, "The Governments reaffirm their intention to maintain the present gold levels of their respective currencies and recognise that their common monetary policy implies the development of international trade. France will not modify her quota policy but will allot the unused quotas of certain countries to the "Gold Bloc" countries, which, according to M. Lamoureux, represents an important amount of trade."[202] And the Times had this to say about the emergence of trade blocs, "It is now becoming recognised that progress towards what all accept as their ideal can best be made by stages, and that the first

[198] M.R.E., B *Questions Financières, Bloc or* (2), p.38.

[199] Figures found in the files suggest that Swiss imports from the Gold Bloc amounted to Swiss francs 520m, whilst exports amounted to Swiss francs 257 millions.

[200] This was not the case though (see Appendix for figures pub. by the L.N., 1935).

[201] M.R.E., p.21, B *Questions Financières, Bloc or (2)*.

[202] see R.I.I.A., reel 301.

stage must be to secure the maximum amount of cooperation between countries which find it comparatively easy to act in concert, whether because of their political and traditional associations or because of the connexion between their economies and currency systems."[203]

The actual protocol (see Appendix) ratified by the Belgian, French, Italian, Luxemburg, Dutch, Polish (Dolezal signing on behalf of the Polish government) and Swiss governments reiterated the signatory governments' belief, which had been affirmed in the London *communiqué* (3/7/33), that stable monetary conditions were an essential element in a return to economic "normalcy". In this regard they renewed their pledge to maintain the existing gold parities, acknowledged that similar monetary conditions prevailing in their respective countries would tend to promote trade between them and were agreed to establish a General Committee composed of their respective delegates. The signatory states would seek means to foster trade relations and agree that it would be "desirable" that trade relations increase 10% by volume on the levels achieved during the period 1st July 1933 to 30th June 1934. In order to achieve this bilateral negotiations should begin as soon as possible. These should finish their work within a maximum time-frame of one year. It was also agreed to submit the draft international agreement on commercial information/advertising to a sub-committee of signatory states which would be charged with couching it in acceptable language in order to secure its speedy endorsement. The protocol also agreed to establish two sub-committees with representatives from each signatory state. These would be concerned with tourism and transport respectively. It was also decided to arrange a meeting as soon as possible of these two sub-committees and to convene a meeting of the General Committee in Bruxelles within three months to consider progress made and to continue to promote its objectives without neglecting the interests of third parties and the need to ensure greater international collaboration.

The note to which the protocol was appended,- a letter from J.Rueff, the Director of the Treasury Department (*Directeur du Mouvement Général des Fonds*) at the Ministry of Finance[204],- included an assessment of the positions of delegations in Bruxelles. Rueff pointed out that whilst public opinion might be divided in Belgium on monetary questions,

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[203] 22 October 1934, R.I.I.A, reel 301.

[204] M.F., 24/10/34, B 32 323.

in particular the banking sector, Jaspar and the members of the government behind him sincerely supported the existing Belgian gold parity. However, the campaign in the Netherlands in favour of devaluation appeared to have gathered momentum and the Dutch Foreign Minister, Steenberghe, had given Rueff the impression that the Dutch government really was hesitating on the course to adopt. This was borne out by the Dutch delegation's reluctance to endorse a *communiqué* in favour of existing gold parities on which the French delegation had been so insistent.[205]

Rueff pointed out, interestingly, that the US Ambassador in Bruxelles had told him that President Roosevelt approved strongly of the Gold Bloc's policy. However, this does not necessarily suggest that the President was interested in stabilising, but, perhaps, in preventing these countries from devaluing. Rueff also indicated that the Belgian Finance Minister, Sap, was particularly keen to meet Germain-Martin, as soon as possible and that as circumstances allowed he would call on him.

Another very useful official French source which allows us to get an insight into the negotiations is the report prepared by the Foreign Ministry for its embassies which sums up the negotiations.[206] The report indicated that Poland was included at its own request. The report made clear that any concessions would remain conditional on member states retaining their gold parities, which probably explains the importance which France placed on securing a renewed commitment to existing gold parities as an integral part of the Bruxelles Protocol. Paragraph B of this report stated that the desired 10% increase in trade volume should be realised within a year. This is the interpretation which Lamoureux put on it too. The General Committee (*Commission Générale*) which met in Bruxelles would now become a permanent standing committee which would supervise the process of bilateral negotiations. Apart from the two sub-committees created to deal with tourism and transport the report mentioned a third sub-committee set up to settle on a final draft for an international agreement covering trade promotion (*propagande commerciale*) which was a League of Nations initiative approved in principle by the Gold Bloc.

Having recapitulated the basis of the protocol the report went on to relate the difficulties encountered in the negotiations and the very real effort which the French

[205] see report of 23/10/34, circulated to French Embassies, M.F., B 32 323.

[206] see M.F., B 32 323, dated 23/10/34.

delegation had to make. The report confirms Mouré's (1991) contention that the Belgians were ill-prepared, though, Mouré added, that the reason was that the Belgians wanted the conference to fail. This is not Bussière's (1988) opinion nor does it appear to be borne out by Belgium's vested interest in freer trade within the Bloc and Jaspar's own personal initiative in getting the conference going. However, the Foreign Ministry paper argued that the Belgian preparation was virtually nil and that the French delegation had to direct the conference debate with the advantage of having set itself definite goals and having brought proposals on all the issues on the agenda.[207] The main difficulty was to keep the Italians on-board. Apparently they did not wish to enter into any commitments, and had the suggested Italian course been followed a series of bilateral negotiations would have been established without assigning to them any fixed goals or time and place.

The Swiss objection rested on the fact that it ran a deficit with all Gold Bloc member states without exception,- the report states that Italy was in the same boat, but this is clearly wrong as Italy ran a surplus against the Gold Bloc[208] - and therefore any across the board increase in trade would merely widen the deficit. And the Swiss raised the pertinent question of how countries not applying quotas, such as Italy, could reciprocate. Whilst the Dutch delegation was keen not to do anything to alienate third parties as Gold Bloc imports accounted for only 16.8% of its total, and 28% of its exports. In the circumstances the French were pleased with the outcome and that their own recommendations had been broadly adopted and that some form of objective had been set against which to measure the outcome of bilateral negotiations.

The resolution in favour of gold parities had not been without difficulties, but worthwhile according to the report considering the strength of the pro-devaluation campaign

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[207] *"Du côté belge, la préparation s'est révélée à peu près nulle et la direction des débats a dû être très rapidement prise par la Délégation française qui avait l'avantage de s'être assigné un but défini et d'apporter des propositions concrètes sur tous les points du programme."*

[208] Quoting from this report (dated 23/10/34), which was circulated amongst embassies abroad, *"Du côté suisse, des objections ont été présentées qui ne sont pas sans valeur. Elles s'inspirent du fait que la Suisse,- l'Italie est dans le même cas,- a une balance déficitaire avec tous les autres pays du bloc sans exception et que l'application trop stricte d'un pourcentage d'augmentation tant aux importations qu'aux exportations aggraverait singulièrement cette situation."*(p.3). However, the assessment of Italy's bilateral trade balance with the Gold Bloc is at odds with the statistics published by the League of Nations Report (1935) viz., *"Chiffres essentiels..."* which are reproduced in the Appendix. These figures indicate that Italy ran a surplus against the Gold Bloc as a whole and a surplus in 1933 with all Bloc states except the Belgo-Luxemburg Union. These figures are confirmed by other sources, e.g., Stucki, who states that Italy was *"créancière du bloc or."*

in Belgium and the attraction exercised by the sterling bloc. The Dutch had been reluctant to agree, pretexting insufficient negotiating instructions. The Italians were particularly opposed. Off the record remarks suggested that Italy did not wish to draw public attention to a question which the Italian press had not been allowed to discuss to date.

The French proposal to seek derogations from MFN met with unanimous opposition and it was with some difficulty that it was agreed that it would be studied and that between then and the next General Committee meeting the signatory governments would decide whether or not it would be put on the agenda of the next meeting. The report went-on to add that only with time, and the work of the bilateral negotiations would one be able to tell whether this initiative would bear fruit. Judging from the discussions in Bruxelles the report suggested that the Belgians and Swiss would be the more forthcoming, again tending to invalidate Mouré's suggestion that the Belgians had not been keen on the conference, and that the Dutch and Italians would prove the more reluctant partners. The report finishes by stating that the Foreign Ministry would be glad to receive assessments of how the conference had been greeted abroad.

In an interview following the Bruxelles meeting the French Minister of Commerce, Lamoureux, suggested that the *Commission Générale* should meet in three months time to review progress made towards increasing intra-Bloc trade by 10%. Lamoureux argued that this should be secured by means of bilateral negotiations. Highlighting some of the difficulties raised by these discussions he argued that agriculture was a problem as France imported more than it exported to the Gold Bloc member states. France, would as a result of the unpredictable nature of agricultural production, have to set quotas every three months within the framework of the overall programme of quotas,[209] as had been the case in the past. These would have to be reciprocated.[210] When asked whether this would be

[209] We know that at the preparatory meeting held on September 29th 1934, the French delegates had been prepared to offer a six-month freeze on agricultural quotas,- *vide, Note pour le Ministre*, 12 October 1934, from Boisanger M.F., B 32 323.

[210] *"Il se réserve seulement, en raison de l'impossibilité des conditions de production du marché agricole, de fixer tous les trois mois, comme par le passé et dans le cadre du programme général, les contingents d'importation des produits de notre agriculture.*

"Il est bien entendu, d'ailleurs, que l'augmentation des possiblités d'importation en France des produits agricoles devra avoir pour contrepartie une augmentation des débouchés offerts aux produits de notre sol." Lamoureux, 22 October, M.R.E., B *Questions Financières, Bloc or* (2). Anyone familiar with the current Uruguay Round of trade negotiations will realise that little has changed.

compatible with MFN, Lamoureux replied that the interviewer had identified the essential difficulty and that this applied to any effort to increase trade relations within a regional grouping.

Agreements and advantages negotiated would be conditional on signatories remaining on gold. The objective was to increase trade by 10% of the level achieved between 1st July 1933 and 30th June 1934. This in part clarifies the declaration following the Bruxelles conference which suggested that bilateral discussions aimed at achieving the desired increase in trade volume could run for a period of up to one year after which the measures would be put into effect. Here Lamoureux suggested that the objective be realised within the year.[211] He pointed out though that the increase in trade volume would not be across the board, but would differ depending on needs and French consumption. Lamoureux expressed his satisfaction at the outcome of the conference and that France had realised most of the objectives that it had set itself.

Asquini, the Italian delegate, and Steenberghe were also interviewed by the Agence Economique et Financière (ibid). Asquini stated that whilst Italy's ratification of the protocol indicated that it maintained its solidarity with the Gold Bloc, account should be taken of Italy's creditor position *vis-à-vis* the bloc (*l'italie créancière du bloc de l'or*) and that it was significantly dependent on extra-Bloc trade, particularly with the UK, Germany and the US. As far as increasing trade by a uniform 10%, Italy felt that a country's relative position should be taken into account and in this respect Italy was clearly interested in boosting its exports (i.e., not see its creditor position *vis-à-vis* the Gold Bloc eroded). However, the Italian government was glad that a pragmatic approach had been adopted. Asquini confirmed that the MFN clause remained a stumbling bloc to any fundamental change in commercial relations. Steenberghe stated that he expected any significant results to issue from the bilateral set of negotiations, but that he was particularly pleased with the state of relations between Belgium and the Netherlands and that he had found the Belgian government keen to expand its trade relations. One should recall the note from the French representative at the Hague to the Minister for Foreign Affairs which hinted at some suspicion of Belgium's motives in calling for a conference (i.e., in order to enhance its own trade) and at Belgium's implicit leverage, viz., threatened devaluation.

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[211] see interview with Agence Economique et Financière, published on 22 October 1934, M.F. B 32 323, this seems to be the same interview reported in the files at the Ministry for Foreign Affairs.

The Polish delegate's declaration (Dolezal) stressed the fact that Poland's participation in the discussions in Bruxelles emphasised her commitment, made in London, to the gold standard. And that this was re-affirmed by its participation in efforts aimed at maintaining the existing standard.

Stucki, representing the Swiss delegation, answered that current policy did conform with Swiss government policy. However, Switzerland's position was somewhat more difficult than that of other Gold Bloc states, particularly Belgium, as it ran a significant deficit against all member states. And therefore when talking about increasing trade by 10% each countries' specific interests had to taken into account. Stucki also emphasised that one should not just look at the trade balance, but also at the balance of payments.[212]

The conference further agreed that if trade between any two countries had not increased beyond 10%, trade should be increased up to the level of the short-fall between other member states so that total intra-Bloc trade would still rise by 10%. The Commission agreed to meet, in Bruxelles, before 1st March 1935 in order to check on progress made to date. The Belgians and French agreed to begin bilateral negotiations on November 5th 1934. An article translated from the Swiss newspaper, *Neue Zuricher Zeitung*, 23 October,[213] pointed out that though a 10% increase in trade might not seem much,- the Dominions and Empire hardly managed this,- but that in any case it would be an achievement to avoid an overall decline in commercial relations. Nevertheless, one cannot escape the fact that the "vision thing" was sorely lacking in the Gold Bloc trade negotiations.

The rather disappointing outcome of the Conference is borne out in an article in, *La Situation Economique et Financière*,[214] which also alluded to some of the difficulties in reaching such an agreement. This article averred that it was on Jaspar's initiative that the Bruxelles conference had been convened. Jaspar, as Belgian Foreign Minister, had at the previous League of Nations session alluded to the benefits of closer economic relations between Gold Bloc members. At first this idea was coolly received, but Jaspar had managed to convene a conference. The article admitted that the results, particularly in the economic field, were rather disappointing. The author of the article did, however, point out that the

[212] Did he mean gold flows or tourist remittances? Most probably the latter.

[213] see M.R.E., B *Questions Financières, Bloc or* (2), p.52.

[214] see M.F., 26/10/34.

re-affirmation of the commitment to existing gold parities was useful, particularly given worries about the Gold Bloc centred around Belgium.

However, the article is far more critical of the commercial provisions of the *communiqué*. It cogently pointed out that the declaration only stated that it would be "desirable" that the volume of trade be increased 10% and that this carried no emphatic obligation. And that the 12 month period set to achieve this by means of bilateral negotiations was long, given existing economic conditions, and that a more expeditious formula should have been adopted. The article added that the goal of raising intra-Bloc trade volume 10% was far from ambitious, as these countries' trade with one another only accounted for some 20-30% of their total trade. Therefore, a 10% volume increase in intra-Bloc trade would only represent an increase in their aggregate trade of some 2-3%! However, the author pointed out that the conferees were not necessarily to blame and that they had made an attempt. Lamoureux had been pessimistic from the start, which is not surprising given the limited nature of the concessions Paris was willing to make - cf., preparatory meeting held on 29th September 1934 at the Ministry of Commerce. He pointed out that whilst in monetary affairs the Gold Bloc might share a similar interest, this was not the case when it came to economic questions. Some countries were agricultural and others industrial. Though it is not clear what is meant here, as complementarity could make it easier to resolve difficulties posed by interest group pressure. However, what is probably meant is that France, for example, might want to protect agriculture, which is particularly prone to instability, this in turn could be a cause of high industrial wages, whilst Belgium would be keener to promote her industrial goods and would want a freer market.

In Belgium's case the Gold Bloc in 1933 accounted for 40% of her markets, whilst the UK, US and Germany only accounted for 28%. French exports to the Gold Bloc amounted to 37%, whilst these other extra-Bloc states accounted for 34%. The paper argued that for France itself these extra-Bloc markets were important. Of course we know that although Belgian trade dependence on these markets was lower it nonetheless remained concerned not to turn these against itself. In fact all Gold Bloc states shared the same concern, though they appear to have reconciled themselves to the idea that Germany would increasingly follow her own autarkic path,[215]- however, this would not be precipitated by

[215] cf., resolutions aimed at establishing a study of the effects of such an eventuality.

the Gold Bloc, but be *sui generis*. In Italy's case exports to the Gold Bloc only accounted for 20% of the total, whilst sales to the UK, US and Germany accounted for 32% of the total. These markets also constituted a more significant outlet than the Gold Bloc in the case of the Netherlands.

Given the different levels of intra-Bloc trade dependence the article argued that it was clear that respective governments would consider intra-Bloc trade liberalisation with differing orders of priority and would have their own agendas. Belgium could only gain, but in Italy's case she stood to gain far more from UK, US and German tariff reductions. And would be unlikely to accept any deal which might lead to a retaliatory rise in tariffs. Furthermore, any concessions would have to be reciprocated and this could pose problems for certain countries. This would explain Italy's reticence, and the author suggested that the protocol was deliberately vague in order to placate certain countries, in particular Italy.

Looking at the explanatory letter circulated amongst Embassies by the French Foreign Ministry which related the progress of the conference debate (*vide supra*) this is certainly the impression one gets. The author of the article felt that difficulties would not be dispelled when negotiations aimed at implementing the protocol began. These difficulties would be compounded by the MFN clause. The article pointed out that because of the need for reciprocity, increased exports would mean increased imports and that this could pose problems for countries (e.g., Switzerland) running a deficit with the Gold Bloc as liberalisation would only widen the trade deficit.

The article argued that though the results were disappointing one should not blame the Gold Bloc which was making the first real attempt to increase trade, but those countries which were not party to the agreement. The paper argued that the Gold Bloc was too small for it to get-off the ground and would need the co-operation of a major trading nation, such as the UK. It argued that if the British would just stabilise their currency, trade would increase and voiced the opinion that sterling's float, the world's vehicle currency, remained highly unsettling.

A letter dated 25 October 1934, from the French Financial Attaché in London to the French Ambassador in London, a copy of which was forwarded to the Ministry of Finance, argued that the British were favourable to the Gold Bloc agreement and that both Sir Frederick Leith-Ross and Waley had not objected, nor did the Times, whilst Sir Walter Layton's Economist was also favourable. If the Gold Bloc were to devalue this would have an impact on British trade and the existence of a stable currency bloc would make it easier, eventually, to stabilise. If the Gold Bloc currencies were to float it would also make the work of the Exchange Equalisation Account harder,[216] as intervention would involve holding open foreign exchange positions.

As the French proposition at the Bruxelles conference to get third parties to agree to derogations to MFN was not adopted the conference had to settle for trade to be expanded by means of un-utilised quota residuals which would be offered to Gold Bloc trading partners. In a letter from the French Minister for Foreign Affairs to the French Ambassador in London it was stated that this should in no way infringe agreements with the UK. The agreement of 27th June 1934, which stipulated that the UK would be entitled to any proportional increase in French quota allocations, allowed, - under section 2 of article 3, - France to negotiate with the UK, or any-other state, the unused residual within overall existing quotas.

However, it is clear that at this early stage of the Gold Bloc's life, as indeed had been the case since the beginning, there was concern whether it would last. In a letter to the French Foreign Minister,[217] dated 29 October, the French Ambassador in Belgium expressed his concern that if the Gold Bloc were to prove a failure the partisans of devaluation in Belgium would win-over. According to this note these were the Flemish Catholics, but even included some French speaking Belgians. Belgium's trade was too important, and the Flemings remained wary of the French. An article in the Financial News 23 October 1934[218] argued that unlike the sterling bloc the Gold Bloc would prove hard to hold together as they would be buying in the most expensive markets. This might force them to become completely autarkic or to devalue, - the latter option seeming the more likely. Marthe Hanau in the newspaper *Forces*, 24/10/34,[219] echoed this sentiment predicting an eventual devaluation of the Gold Bloc, as the highly protectionist and deflationary measures practised in Germany would prove politically unacceptable except, possibly, in Italy. Furthermore, as opposed to the sterling area the Gold Bloc states would be buying in the

[216] M.F., B 32 323.

[217] M.R.E., B *Questions Financières, Bloc or* (2).

[218] R.I.I.A., reel 301.

[219] 24/10/34, M.F., B 32 323.

most expensive markets, "under such circumstances how long could it be expected to last?"

Lamoureux, French Minister of Commerce, clarified the position declaring at the French Embassy in Bruxelles that for the time being the level of quotas would not be raised as countries such as the UK would under the circumstances automatically qualify for a fixed percentage increase.[220] He also re-affirmed his opinion that MFN constituted an impediment to trade revival.

The view that MFN could act as a constraint on trade liberalisation was echoed in a speech delivered at the Chamber of Commerce of Paris on 11/12/34 by J. de Neuflize (Regent of the Bank of France), entitled: "*Examen des Mesures Economiques Envisagées par les Pays du Bloc-or à la suite de la Conférence de Bruxelles.*"[221] De Neuflize argued that MFN would circumscribe any potential trade liberalisation which could issue from the bilateral trade negotiations.

A note to the Minister for Foreign Affairs,[222] dated 30 October 1934, confirmed the differences within the Dutch government on the issue of increasing intra-Gold Bloc trade. The Dutch viewpoint was that negotiations would probably not lead anywhere, that bilateral negotiations would be needed, but that they remained locked-in with Germany. This was the view of the Dutch Minister for Economic Affairs who did not want to antagonise the Germans. The Dutch appear to have subscribed to the view that the Belgians were trying to obtain unilateral concessions in the negotiations by using the threat of suspending the gold standard. The note pointed out that the recent Belgian request to float a loan on the Amsterdam bourse had been turned-down. The note also expected the UK to ask for MFN treatment if any deal was reached.

An article in, Le Journal des Finances (26 October 1934)[223] examining the background to the Bruxelles conference suggested that Serre, a former Minister of

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[220] "*Il n'est pas question, a-t-il avoué, d'augmenter, pour le moment, le volume des contingents, les pays qui, tel l'Angleterre, ont un pourcentage déterminé, verraient celui-ci augmenté automatiquement.*" Lamoureux's statement is reported in an article in, L'Indépendence Belge 29 October 1934, from M.R.E., document 102, B *Questions Financières Bloc or* (2).

[221] Quoting de Neuflize, "*Comme par ailleurs, vu l'impossibilité de porter atteinte à des situations acquises (en raison de la clause de la Nation la plus favorisée), il faudra se résigner à ce que les conventions douanières, qui seront passées entre pays du bloc-or, n'aient pas toute l'efficacité désirable.*" B.F., *archives*, 4 N 384 B.

[222] M.R.E., *Bloc or* (2).

[223] source: M.F.

Commerce, had approached Gold Bloc states following the London declaration of July 1933, on the possibility of a trade agreement. However, according to this source, this was not taken up at the time as no one wanted to risk alienating Germany which had not yet fully embarked on its autarkic course. The idea was taken up a year later by the Belgian Foreign Minister, Jaspar, as Belgian industry came under increasing strain. J.Piel, author of the article, argued that the French were favourable, predominantly for diplomatic reasons, as it would encourage closer relations with Italy and cement a western alliance facing Germany.

The article argued that at the Franco-Belgian bilateral beginning on November 5th the most difficult questions would revolve around MFN and the need to avoid breaking with the sterling and dollar blocs, in particular. This is why Lamoureux had suggested a request for derogations from MFN, which were rejected by the other participating delegations at Bruxelles. Piel stated that the residual of quotas were meagre, unless Germany pulled-out of existing trade agreements, and that it would lead to complaints from third parties. Those Gold Bloc states without a quota system would find it hard to reciprocate. He suggested that the bilateral meetings could examine tariff concessions on goods in which both parties enjoyed certain advantages, any tariff reductions could be tailored so as to benefit only Gold Bloc member states, thus getting around the MFN problem. This would be relatively easy if transport costs, for example, were carefully calculated as the Gold Bloc states were geographically contiguous, excepting Poland, and therefore benefited from a comparative cost advantage. Piel pointed out that quotas posed greater problems for trade liberalisation than tariffs, as quota concessions would have to be reciprocated, whilst tariffs remained a more flexible instrument. He therefore suggested a policy of tariffication.

His point, which is well made, is contrary to the stance adopted at Geneva and Bruxelles. However, tariffication would extinguish the rent which producer groups entitled to quotas currently enjoyed (aside from the rent which domestic producers earned as a result of protection) and they could be expected to lobby for compensation.

Piel particularly commended the renewed declaration in favour of existing gold parities for its psychological impact in an environment in which the devaluation campaign in Belgium and Holland had renewed.

Ahead of the first bilateral Franco-Belgian commercial negotiations, set to begin in Paris on 5th November 1934, a note from the French Ambassador to the Minister for Foreign Affairs warned that Belgian industrialists and bankers, who felt that the only prospects for recovery were in an abandonment of the gold standard, were afraid that closer economic relations within the Gold Bloc would permanently close-off the markets of countries which had left the gold standard.[224]

Eichengreen's judgment is that commitment to the gold standard was weakest in Belgium as it was dependent on industrial exports to UK markets and its agricultural sector was also affected by depressed economic activity and that as financial intermediaries had lent heavily to both they were less vocal in their opposition to devaluation when exporters began to press for devaluation.[225] He argues that as Switzerland and the Netherlands had solid reserves and were financial centres there was less support for devaluation.[226] And that as politics were more divided along confessional lines in Holland it was harder for a coalition of interests to develop.[227] In the case of France Eichengreen also casts the devaluation issue in terms of interest group pressure. He argues that in France the export and importing competing sectors were not so important and the latter could be bought off with tariffs and quotas. He adds that in France the agricultural sector was less indebted than in the US and therefore less prone to lobby for devaluation.[228] And farmers were afraid that devaluation and reductions in tariffs and subsidies (which maintained prices above world levels) would go hand-in-hand, certainly following devaluation tariffs were reduced.

Eichengreen (Golden Fetters) also argues that in France the authorities were reluctant to abandon gold as it represented a fiscal compromise and that suspension of the gold standard would lead to inflation and financial instability. However, in France the question of the fiscal burden was still a problem compounded by slack revenue as a result of depressed economic activity. And it proved virtually impossible in the 1930s to build a coalition which would allow a decision on the balance between expenditure reductions and revenue raising measures, as a result temporary coalitions were invested with decree-making

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[224] *"Les industriels et les banquiers qui ne voient de salut pour l'économie belge que dans l'abandon de l'étalon or ont pris peur à la pensée que leur pays en resserrant ses liens avec le bloc de l'or allait se fermer à jamais les marchés à monnaie dépréciée."* (document 116, M.R.E., B *Questions Financières, Bloc or* (2).

[225] see Golden Fetters.

[226] op.cit., p.288.

[227] op.cit., p.314.

[228] op.cit., pp.287-288.

powers which were not renewed. Reluctance to devalue is rather due to the fact that the authorities thought that devaluation would only cause inflation, and erode credibility without reducing the fiscal burden, with the result that the situation would only have worsened. One can safely say that both Germain-Martin and Reynaud shared that opinion.[229]

Concern that Belgium might devalue was registered in Luxemburg which was in a monetary union with Belgium. In a note dated 26 October 1934,[230] from Cambon, Minister of France in Luxemburg, to the Minister for Foreign Affairs, reporting a conversation with Bech (who represented Luxemburg at the Gold Bloc conference), Cambon reported Bech's view that a 10% increase in trade could be obtained, but that there were indeed worries that Belgium would devalue. However, Bech argued that should this come to pass Luxemburg would be obliged to adopt the French franc and that this should act as a sufficient deterrent to the Belgians from devaluing. Luxemburg appeared to be grossly over-stating its significance.

A note from the French Ambassador in Switzerland also underlined the difficult nature of the forthcoming bilateral Franco-Swiss trade negotiations planned for 14th November 1934.[231] And discounts which Swiss hoteliers offered British tourists raised fears for the Swiss franc. Swiss hoteliers agreed to exchange sterling at a rate of 16 to the pound, whilst the official parity stood at a little over 15.[232]

A letter from the French Consul in Basle to the Foreign Minister (dated 15th November, 1934)[233] reported on the latest meeting of Gold Bloc central bank governors in the margins of a BIS meeting. It also registered concern at Swiss hoteliers' discounts. Arguing that this had contributed to pressure on the Swiss franc and that a 10% discount to their British clientele would have been more judicious. Dr. Bachmann, the President of the Swiss National Bank, also used the BIS meeting as an opportunity to clarify the new Swiss legislation on foreign investments by private Swiss banks. He pointed out that the bill had been amended so as not to curtail private banks' autonomy too significantly. Bachmann

[229] see chapter seven of this thesis.

[230] see M.R.E., B 32 323.

[231] M.R.E., p.142, B *Questions Financières, Bloc or* (2).

[232] see p.172 M.R.E., B *Questions Financières, Bloc or* (2).

[233] source: M.F.

admitted that the discussions on the issue of banks subject to difficulty had not been particularly useful in re-assuring the public. Despite these difficulties the Consul reported that official Swiss monetary policy had not changed.

However, the French Consul did stress that according to reports to which he was privy the Dutch and Belgians seemed "wobbly" on the monetary question. The Consul reported that these two countries' economies were dependent on foreign markets and could not afford to take an autarkic route. They were willing, however, for social reasons (i.e., the protection of savings and real wages) to stick to existing gold parities. However, the gold parity was not an end in itself but, rather, the means of securing a stable economic environment. The latter objective meant that trade within the Bloc had to expand,- should protective measures prevent this these countries might have no option but to join another currency bloc, viz., sterling. That is why, he argued, Belgium and the Netherlands insisted in Bruxelles that intra-Bloc trade be raised by 10%. The Consul reported that the constitution of the Flandin government, and its liberal rhetoric, had restored hope both in Belgium and the Netherlands that this objective could be realised.

The Consul suggested that the Belgians were using the threat of devaluation as a means of pressuring the Bloc into trade concessions, this is what the Dutch had argued at the Bruxelles conference (*vide supra*). However, he suggested that this was in part a hollow threat, as it was not guaranteed that Belgium would be admitted to the sterling bloc if it did devalue, particularly as British policy seemed to be dictated by the need to protect her industrial interests.[234] He also argued that as soon as Belgium had abandoned gold she could no longer expect to enjoy French tariff concessions. However, the Consul was obviously ill-informed as Belgium did not enjoy any preferential French tariff concessions!

The Consul reported that his source for the Belgian and Dutch views had concluded that it could therefore be expected that the Gold Bloc would not collapse in the coming months. This proved, a wholly misplaced judgement!

The Consul went on to suggest that the re-election of President Roosevelt augured well in this regard, as Roosevelt did not want a further devaluation of the dollar, for the time being! The recent relaxation of restrictions on US capital outflows had also raised hopes

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[234] Quoting the report: "*...les industriels Belges sont en effet les rivales dangereuses des industries britanniques et toute l'orientation anglaise actuelle du parti conservateur tend à protéger les intérêts industriels anglais.*" Letter from French Consul to Foreign Minister, 15/11/34, M.F..

amongst central banks that the dollar would be stable in the coming months. The fact that the UK had little interest in allowing sterling to weaken if the dollar was stable meant that the prospect for monetary stability in the coming months was greater than in the past two years and that this made central banks more optimistic about the future.

However, sterling would weaken in March 1935 which left the Belgian authorities in the intolerable position of having to raise interest rates to defend the currency,- given domestic factors Belgium chose to devalue. Bringing the Gold Bloc experiment, effectively, to an end.

The sub-committees which had been appointed as a result of the Bruxelles conference were set to meet at the Ministry for Foreign Affairs in Bruxelles. The committee for commercial propaganda on 22nd November 1934 and the committee for tourism and transport on 26 November 1934.

Foreign exchange markets did not react favourably to the Bruxelles commitment to promote trade within the Bloc and the Belga came under pressure on 5th November[235] the outcome of the trade negotiations between Gold Bloc states was thought unsatisfactory.[236] However, Jenny in *Le Temps*, pointed-out that opposition to devaluation in Belgium remained strong (this is not an impression one gets from other sources, maybe he was trying to shore-up French public confidence) particularly because of fear of inflation; possible retaliation; and the expropriation of savers,- he also pointed out that the socialists were against devaluation. This was also the case in Switzerland, and one should recall that one of the staunchest defenders of the gold standard had been the British Labour and National Chancellor of the Exchequer, Snowden. The French communists opposed devaluation too.

In the files at the Ministry of Foreign Affairs we find reference to aid provided by the Fed. to the Gold Bloc in the form of assistance to one of its members. However, it was pointed-out that this was by no means disinterested, as preventing these countries from devaluing would allow the US to maintain an undervalued currency. An article in the Financial News affirmed that the Bank of England was particularly opposed to a Gold Bloc devaluation, whilst the Treasury was less dogmatic.[237] A subsequent article pointed-out

[235] Financial News, R.I.I.A..

[236] see *Le Temps*, 19 November 1934, R.I.I.A..

[237] 27 November 1934, R.I.I.A..

that whilst, "At the time of the Ottawa and London conference, the whole world was invited to join the Sterling Bloc, and a few months ago the Chancellor of the Exchequer offered a practical inducement to those desirous of joining by relaxing the embargo on foreign loans in favour of members of the group,"[238] the attitude had apparently changed now that it was realised what an advantage an undervalued currency secured.

An article published in the Financial News, on 30 November 1934,[239] suggested that the Fed. was opposed to a devaluation of the Gold Bloc, and in particular of the belga (presumably because it was under the greatest threat), and that it was taking silver from Belgium rather than gold. The article pointed-out that of the Gold Bloc countries only Switzerland and Holland would be eligible for a loan, as the others had defaulted adding, however, that in the present circumstances a loan issue was not likely on the US market. Somewhat later, on 26 February 1935, an article published in *Le Temps*[240] argued that the Dutch authorities kept the short-term loan market open to foreign "sovereign" borrowers, but only against commercial advantage. The long-term capital market was strictly reserved for domestic issues, as a result the State, local government, and the Dutch East Indies (whose paper enjoyed a state guarantee) had managed favourable debt conversions, with the long term rate of interest then at 3.5%. This is from an article by P.-G.Martin, the article also stated that Holland went-in for protectionism and agricultural dumping. The Financial News, of 7 December 1934, did point-out that around that date Belgium had received a loan from Holland, which had no real effect though. This suggests an ambivalent relation with Belgium, though the earlier Dutch refusal to allow the Belgians to tap their capital market may have been conditioned by other demands on its market. The loan was undoubtedly the 100,000 guilder loan mentioned in Eichengreen.[241] The Dutch stipulated that the loan be repaid in gold. This illustrates the uncertain prospect with which these currencies were viewed.

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[238] Financial News, 29 November 1934, R.I.I.A.

[239] R.I.I.A. press library.

[240] see R.I.I.A.

[241] see Golden Fetters, p.361.

An article in the Statist, dated 17 November 1934,[242] argued that France could not devalue without knowing what the British would do as the UK had not committed itself to any particular rate of exchange. The article went on to argue that the British and other Exchange Equalisation Accounts were in a sense free-riders as they could manage their exchange rates without great exchange rate risk by buying and selling Gold Bloc currencies. This effectively provided exchange rate cover free of charge. Therefore a currency agreement would be needed in the case of a Gold Bloc devaluation in order to settle the difficulties of intervention, but the UK had little incentive to do anything.

As we will see it was argued that one of the reasons for the "24hr. gold guarantee", introduced as part of the Tripartite accords, was that intervention could be undertaken at known parities. This was prompted by the French devaluation which only left the belga on gold (the UK E.E.A. was loath to hold open exchange positions and a 24 hr. guarantee would provide cover for exchange rate intervention risk). The 24 hr. exchange guarantee was also introduced to bridge the time zone during the trading day between Europe and New York, so that all transactions effected on the same trading day, in different time zones, could be cleared at the pre-agreed rates.[243]

A note from the *Ministre de France* to the Foreign Minister, dated 5/12/34,[244] reveals that the Canadian press were apparently afraid that the Gold Bloc would close its trade, and the easiest solution would be for everybody to join the sterling bloc - which would eventually happen *de facto* - and that in any case the days of the Gold Bloc were numbered. On 12th February (1934) the Financial News reported Dr. Colijn, the Dutch Prime Minister, declaring that Holland was not held by the Gold Bloc and, "has her complete liberty," and adding that he did not know whether it would hold together. This did not exactly augur well particularly as Colijn held conservative and orthodox views.[245] The Financial News of the same day also reported a visit to London by Flandin who was apparently disappointed that

[242] M.R.E., B *Questions Financières, Bloc or* (2), a translated copy of which is held at the Ministry for Foreign Affairs.

[243] see Appendix.

[244] M.R.E., B *Questions Financières, Bloc or* (2).

[245] see Griffiths, et.al., (1987).

the British attitude to stabilisation had not changed.[246]

In 1935 Laval would propose trade concessions to states which would pledge themselves not to devalue. According to Gignoux (1943) this plan failed because the British, who wanted to maintain their floating currency, did not endorse it at the League of Nations assembly.[247] This is confirmed by Eichengreen who argues that Laval tried to induce the British authorities, in July 1935, to stabilize sterling, presumably so that his deflationary programme no longer had to compete against a moving target, but Whitehall refused.[248]

LITHUANIA'S MEMBERSHIP OF THE GOLD BLOC:

In late 1934 Lithuania initiated a *démarche* to enlist support for its application to become a party to the Gold Bloc. In a letter dated 7th December 1934 the French Foreign Minister enquired from the Minister of Finance whether or not Lithuania fulfilled the technical requirements of a gold standard currency. This was followed by further enquiries directed at the Minister of Commerce, in a letter dated 12/12/34, in which the opinion of the Ministry was sought concerning membership of the Gold Bloc for Lithuania which would entitle it to the same benefits enjoyed by other Gold Bloc member states.

The reply from the Minister of Commerce and Industry, dated 15/12/34,[249] indicated that he would support Lithuania's application, as it had maintained its gold standard and France enjoyed a positive trade balance with Lithuania. However, the Minister of Finance in a letter to the commercial relations section of the Ministry of Foreign Affairs[250] suggested that Lithuania's application should be directed through Jaspar, the Belgian President of the group of states which had remained faithful to gold, and not Paris, as

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[246] source: R.I.I.A. press library.

[247] Quoting Gignoux (1943) on Laval's proposed currency and trade agreement, "... *sur le plan commercial, cette tentative comporta l'offre ferme d'avantages douaniers à tout pays qui s'engagerait à maintenir sa monnaie stable pendant la durée de l'accord à intervenir; l'Angleterre, qui désirait conserver sa livre flottante, fit, à l'Assemblée de la S.D.N. échouer ce projet.*" in, C.-J.Gignoux, L'Economie Française entre les deux guerres 1919-39.

[248] Golden Fetters, p.371, footnote 47.

[249] M.R.E., B *Questions Financières, Bloc or* (2).

[250] see M.F., B 32 323, dated 10/1/35.

suggested by the Ministry for Foreign Affairs, so that France would not be seen to be exercising any dominant financial role within the Bloc. The Governor of the Bank of France, Moret, in a letter to the Minister of Finance,[251] confirmed that the Lithuanian currency, the Litas, was effectively on gold. He provided the following details: since 1922 the Litas had been maintained between its gold points and notes were convertible in currency or gold, at the discretion of the Bank of Lithuania. However, whilst acquiescing in Lithuania's signing up to the London declaration, Moret pointed out that the Bank of France and fellow members of the Gold Bloc were of the view that, in the present circumstances, it would not be appropriate if the technical co-operation agreement of 8th July were extended to Lithuania.

In a letter of 11/12/34 the Lithuanian Chargé d'Affaires signified Lithuania's adherence to the Gold Bloc's London declaration to the Belgian Foreign Ministry.[252] Lithuania also requested that it be invited to the next meeting of countries remaining on gold. The Belgian government was willing to invite Lithuania to this meeting and sought the Quai d'Orsay's opinion.[253] The French government agreed to Lithuania's request.

A letter from the Belgian Ambassador in Paris to the Minister of Foreign Affairs records that Belgium had no objections to Lithuania's being represented at the forthcoming meeting of the General Committee of states remaining faithful to gold. A reply, dated 9/1/35 from the French Minister for Foreign Affairs let it be known that France had no objections either. A letter from the Minister of Finance to the Minister for Foreign Affairs informed the Minister that after consultation with the Bank of France there would be no objections regarding the admission of Lithuania.

The Poles in a letter dated 12/3/35 indicated that they could not express an opinion on Lithuania's application to join the Gold Bloc as Poland did not entertain diplomatic relations with Lithuania.[254]

[251] M.F., B 32 323, 26/12/34.

[252] see F.M., B 32 323, 9/1/35; and M.R.E., B-57-7, 1935; *Questions Financières, Bloc or.*

[253] see letter dated 9/1/35, *supra.*

[254] M.R.E., B-57-7, 1935, *Questions Financières, Bloc or.*

Files at the Ministry of Finance afford some insight into the nature of support operations conducted within the Gold Bloc. The Bank of France would make francs available to Holland and Italy against gold for intervention purposes. These would be sold for dollars which would then be used for purchases of their own currencies. This could only work though if the franc was not under pressure. However, it appears that the Belgian central bank preferred to operate through the Fed. However, as the shipment of gold to New York took too long it arranged to obtain dollars as soon as the gold was shipped. As this was publicised, weakening the Belgian franc, the Belgian and Swiss (and others) authorities arranged for the Fed. to extend loans through the BIS so that foreign exchange markets would not know which currency was being supported. The upper limit against which the BIS would be allowed to offer support, on behalf of the FRBNY, was set at $50m.[255]

The Bank of France also provided loans to Poland secured on deposit of gold at the Bank of France. These loans were consolidated into a 215 million zloty loan at 4% in July 1933. The Bank also arranged a three month revolving credit to begin on 30/7/33.[256] The three month revolving facility was constantly renewed and in November 1935 Wroblewski, President of the Bank of Poland, requested a new 50 million gold zloty credit.

The new government was in need of foreign exchange, as its reserves had been depleted by the capital exports which had followed Marshall Pilsudski's death. The credit would be a three-month non-renewable facility to be reimbursed in fine gold and secured by commercial bills. The gold, though, would remain at the Bank of Poland to avoid any adverse psychological effects which a fall in its reserves would have. The interest rate was fixed at 3.75%.

It is important to note that the Governor of the Bank of France reminded the regents of the Bank that the French government viewed the Polish request with favour.[257] The

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[255] see report from *Consulat de France à Basle* to the Minister for Foreign Affairs 13/12/34, M.R.E., B *Questions Financières, Bloc or* (2).

[256] B.F., *Délibérations du Conseil Général*, 20/7/33, n.124.

[257] Quoting the minutes, *"Il croit savoir (le Gouverneur), d'autre part, que le Gouvernement français verrait d'un oeil favorable la Banque de France faire le geste de solidarité qui lui est demandé."* from, B.F., *Délibérations du Conseil Général*, pp.446-447, 14/11/35, n.125.

request was approved and the credit was open from 19/11/35. However, de Neuflize and Duchemin (head of the French employers federation), both regents of the Bank of France, added the rider that the Bank of Poland should be urged to inform the Polish government of the intolerable situation facing French business in Poland.[258]

However, by early 1936 Koc, the new Governor of the Polish central bank, then in Paris, had to inform his counter-part, Tannery, that the Bank of Poland did not have the necessary foreign exchange to repay the credit falling due on 19th February. Koc did not wish to make the payment in gold, because of the adverse effect the fall in reserves would have on public sentiment. He therefore asked Tannery whether he would allow a three month renewal of the credit outstanding on this facility, which then stood at 26 million gold zlotys. Koc promised to make staggered repayments of 1 million zlotys so that by 19/5/36 the outstanding balance would be reduced to 17 million zlotys.[259]

Tannery met the Minister of Finance to discuss this, and was informed that the government was particularly favourable in view of Franco-Polish relations.[260]

The minutes of the Bank indicate the existing facilities which had been made available to Poland by early 1935, excluding the above mentioned credit. This included a 180 million gold zloty credit which had been renewed for a three month period from 31/1/36. This was backed by an equivalent deposit of gold at the Bank of France. On top of this the Bank of Poland had a free gold deposit at the Bank of France of 74 million francs. It was agreed that the Bank of France would extend, as needed, credit to the value of this free gold deposit. The 180 million credit was renewed and raised to 200 million zlotys on 7/4/36.[261]

The Bank of France also made facilities available to Rumania. The three month credit facility first extended to Rumania on 26/12/31 had been periodically renewed and stood at

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[258] Quoting the minutes, *"Il croit cependant qu'il conviendrait de prier la Banque de Pologne d'attirer l'attention de son Gouvernement sur la situation intolérable qui est faite actuellement aux industries françaises en Pologne."* from, B.F., *Délibérations du Conseil Général*, 14/11/35, n.125.

[259] B.F., *Délibérations du Conseil Général*, pp.73-75, n.126.

[260] *"D'un entretien que M. le Gouverneur a eu avec le M. le Ministre des Finances, il ressort que le Gouvernement considérerait l'octroi des facilités demandées par M. Koc comme particulièrement opportun en l'état actuel des relations franco-polonaises."* from, B.F., *Délibérations du Conseil Général*, pp.73-75, n.126.

[261] B.F., *Délibérations du Conseil Général*, n.126.

145 millions francs on 3/9/36.[262] The loan stood at 175 millions francs on 12/3/36 and 160 million on 18/6/36.[263]

It is clear that these loan facilities to Poland and Rumania followed the pattern of financial diplomacy begun in the 1920s and sedulously pursued by Moreau.[264] The facilities made available to Poland cannot really be considered evidence of co-operation under the aegis of the Gold Bloc. It is safe to say that these credits would have been made available whether Poland were a party to the Gold Bloc or not. This is evidenced by the clear political support which Tannery received from the French government in favour of extending these facilities. And the fact that when Poland failed to follow other Gold Bloc states and devalue, maintaining an increasingly closed financial and trade regime closer to Germany, France continued to provide Poland with loans.

THE GOLD BLOC IN DISARRAY:

Monick, the French Financial Attaché in London, did not appear bullish about the Gold Bloc's prospects. This appears in a letter dated 17/12/34,[265] addressed to the Minister of Finance which is a comment on an article published in an Italian newspaper, the *Popolo d'Italia*, allegedly penned by Mussolini. The article argued that deflation had gone far enough, whilst the commitment to gold was re-affirmed, a rise in prices abroad could be expected to finalise the adjustment,- one of course immediately thinks of similar arguments adduced in the UK before the 1925 stabilisation with a rise in US prices expected to smooth the final adjustment process. Monick argued that this was too optimistic and pointed-out that though the economist index had risen 6.7% in the UK since the beginning of 1933, sterling had fallen against gold by 16.3% so real gold prices in the UK had actually fallen. Monick added that he did not expect prices in the US to rise further, and that though technically the Gold Bloc countries had ample gold reserves to defend their respective currencies he wondered whether they would be patient enough. Monick gave the following figures for

[262] B.F., *Délibérations du Conseil Général*, 3/9/36, n.127.

[263] B.F., *Délibérations du Conseil Général*, n.126.

[264] see Moreau (1954).

[265] M.R.E., B *Questions Financières, Bloc or* (2).

metallic cover, over 100% in France; 140% in Switzerland; 70% in Belgium; 90% in Holland; and 45% in Italy. Drummond pointed out that Monick was a convinced devaluationist.[266]

Apparently Flandin, who was then Prime Minister, had told Mrs. Mac Cormick of the New York Times that he felt that the Gold Bloc countries could do nothing until the dollar and sterling were stabilised against one another. As we will see the problem of securing an international stabilisation agreement was to prove intractable for a further year, largely explaining France's failure to devalue.

1934 had not been a particularly successful year for the Gold Bloc and the devaluation of the Czech crown in that year (in February) was to be the object of much speculation about the prospects for the Gold Bloc. As the Czech crown was at least nominally on gold, it was sometimes referred to as a Gold Bloc currency. The important point though is that a further gold currency had succumbed, and this was not without leaving an unfavourable impression.

Already by mid-1934 it was clear that Italy had increasingly parted company with the Gold Bloc and the Abyssinian crisis/invasion would be the catalyst for an increasingly protective currency and trade regime imposed in Italy. By early 1935 and the devaluation of the belga it would be increasingly obvious to policy-makers that the Gold Bloc states were functioning on borrowed-time and French governments were already discussing informally, though with obvious intent, conditions under which some form of international currency stabilisation agreement could be reached which would allow the French franc to be devalued. This is despite an increasingly vehement campaign directed against those gathered around P.Reynaud who became an increasingly articulate and convincing advocate of devaluation. This campaign against devaluation was in part orchestrated by the authorities, partly, it seems, to prop up the French franc.

A letter from Duchemin to another regent of the Bank of France argued that recent articles published by Reynaud, in favour of devaluation, in *Agence Economique et Financière* were dangerous. And that they should try and put pressure on the Agence to stop publishing them. And get the Ministry of Finance to do the same. It was suggested that they also get in touch with Reynaud and ask him to desist.[267]

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[266] see Drummond (1981) p.203.

[267] see letter dated 11/8/34, in, B.F., 4 N 383, *service des études* I.

One should note that, "As early as January 1935, the French had discussed with the British the idea of a coordinated devaluation by all the Gold Bloc currencies, followed by monetary stabilization and a reduction of trade barriers."[268] This was during the Flandin government, with Germain-Martin at the Finance Ministry.

Nevertheless, at the beginning of 1935 governments were still endeavouring to promote their feeble, and less than ambitions, efforts at greater economic co-operation within the parameters set at Bruxelles which aimed at increasing trade within the Bloc by 10%. Italy adhered to the convention on commercial propaganda on 11th February 1935. The Poles did so by letter dated 16th February, as well as accepting the recommendations of the sub-committee on tourism, though they drew attention to the declaration of their delegate to the effect that any concessions to Polish nationals travelling to Gold Bloc states be compensated by merchandise trade concessions in Poland's favour. Poland obviously expected a tourist deficit.[269] On the 16th the Belgian Ambassador signified his government's adherence. The convention on tourism was adopted by the Belgian, French, Italian and Luxemburg governments, whilst the Dutch and Polish governments gave their unofficial agreement, "*officieux*." These confirmations were channelled through the Belgian Ambassador, the Belgians continuing to act as conduits for intra-Gold Bloc negotiations. On the 23/3/35 the Swiss notified the Belgian Ambassador that they agreed to the immediate constitution of a permanent Commission of Delegates of National Tourist Boards of Gold Bloc member states. This occurred just as Belgium was devaluing! One cannot, but marvel at the lack of ambition of any of these initiatives. Deflation and depressed economic activity meant that interest group leverage would be that much greater, e.g., French agriculture, despite an inherent contradiction between agricultural protection and the objectives both practical and philosophical underpinning orthodox deflationary policy.

Files at the Ministry for Foreign Affairs underline conditions within which trade concessions were made within the Gold Bloc namely, that countries party to the Gold Bloc

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[268] Golden Fetters, p.378; see also Mouré (1991) pp.230-236. Mouré, though, argues that Flandin sought to prevent a further weakening of sterling which jeopardised his reflationary programme. And that France was willing to help support sterling, whilst offering trade liberalisation measures as a *quid pro quo*. Mouré records that Monick was soon advocating a unilateral devaluation of the franc. Monick's paper is dated 1/9/35. cf., Mouré (1991) p.234.

[269] source: M.R.E., letter dated 16/2/35, *série B carton 57 dossier 7, 1935. Questions Financières. Bloc Or.*

would forfeit all advantages should they renounce gold. It was also specified that the accords reached in Bruxelles did not constitute derogations from MFN and that no preferential tariff agreements had been reached as this would have needed the assent of third parties, or departure from MFN. It was thought that quotas allowed a broader interpretation with respect to MFN. France had agreed to expand trade by using quotas not distributed during negotiations and those not taken up by countries entitled to them.[270] This attitude was adopted in order not to cause friction with Great Britain. Greater co-operation on commercial matters was agreed to, "resist offensives from anglo-saxon nations and also to make their deflationary policies coincide with an increase in business which is indispensable to the success of this enterprise."[271] The reference in this text to "offensives" is pure mercantilist rhetoric. The same source argued that the UK had a vested interest in preserving the Gold Bloc as it maintained the French franc at a relatively over-valued parity.

The paper, though, argued that the British might assist the other Gold Bloc countries stabilise their currencies against sterling which would leave France isolated,- which rather contradicts the earlier argument that the UK had a vested interest in the *status quo* if to "stabilise" is taken as a euphemism for devaluation as it so often was. In the circumstances the best solution would be to try and ensure that the Bruxelles agreements worked. The British government could be expected not to undermine it in such circumstances. This paper with its rather mercantilist tone suggests an interpretation of the Gold Bloc as a zone of influence, but it is hard to imagine that French policy-makers could have been at all happy with its limited radius particularly in the fast deteriorating international climate. And as we shall see exchange controls, as proposed in 1938 by the short-lived second Blum government, would, in part, be rejected as an alternative strategy to the more open Tripartite Agreements as it would mark too clear a break with the democracies.[272]

However, the hopeless inadequacy of efforts made to date and the conflict of domestic interests militated against any broad agreement. This is only too evident in a letter from the Minister of Commerce, dated 29 January 1935, responding to a question from the Ministry

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[270] Though in theory this could still lead to trade friction as a quota, even if not fully used, could still be considered an entitlement.

[271] source: M.R.E., B-57-7 1935 *Questions Financières - Bloc or.*

[272] see Lefranc (1974).

of Foreign Affairs on whether the next meeting of the Gold Bloc should include discussion of derogations from MFN, that is mutual tariff concessions, and whether discussions with third parties should be undertaken. Such an initiative was discouraged by the Minister of Commerce as he saw no advantages in the form of agricultural quotas which could be extended to Poland, Italy and Holland, as France was progressively reducing its agricultural quotas and the extra quota allocations extended to Belgium had not been reciprocated, and because of fear of retaliation by third parties.[273]

The "*Commission du Bloc Or du Comité International des Echanges*," which consisted of industrialists and members of Chambers of Commerce meeting at the "*Fédération Nationale des Chambres de Commerce et d'Industrie de Belgique*," in Bruxelles on 12th February 1935 called for increased quotas between Gold Bloc countries and that these should not be subject to MFN. This committee also recommended negotiations with the UK in order to get to know its position and that tariff barriers be brought down between the UK and the Gold Bloc. The committee, though favourable to the principles of the Bruxelles protocol, called the desired 10% increase in intra-Bloc trade derisory. Though this initiative is of little importance it does demonstrate that what had been done so far was insufficient and by implication that a lot more should be done. Given the impossibility of implementing the committee's recommendations, which might well have invited retaliation, it is obvious that the Gold Bloc was running out of options.

By the first quarter of 1935 it was becoming increasingly apparent that the Gold Bloc had little future. Paradoxically the campaign against devaluation was running at its height whilst Laval would pursue his deflationary policies by decree from June 1935-on. A note dated 11/3/35 at the Ministry of Finance[274] stated that the Gold Bloc was falling to pieces and amounted to little, with Italy having already introduced capital controls. The paper raised the prospect that the US and UK currencies could be allowed to slip. Already sterling's weakness was a cause of great concern to the Bloc and France would even consider introducing compensatory tariffs. Sterling's weakness was soon the catalyst for the belga's devaluation.

The note argued that it would be necessary to secure participation within the Gold

[273] see M.R.E., B 57-7- *Questions Financières*, 1935, *Bloc or*.

[274] M.F., B 32 323.

Bloc of the US and UK. Should this fail then France would have a perfect excuse to introduce autarkic policies. However, an election was in the offing in the UK (it was held in October 1935). This precluded any commitment on the part of H.M.'s Government to currency stability which might impair the domestic policy of cheap money. The autarkic option was eventually rejected by the first Blum government as too damaging internationally for it would cut France off from the democracies.

In the eyes of the Manchester Guardian Italy was no longer on the gold standard as of end-1934. The Manchester Guardian dismissed Italy's claim to be on the gold standard, "In December 1934, however, Italy tightened up her exchange restrictions (existent since 1932) to such an extent that her claim was no longer plausible."[275] New customs regulations had also been introduced to defend the lira.[276] On the 16th February Italy introduced an import licensing scheme which would affect France and Belgium,- it was said that Agnelli was instrumental in its introduction.[277] According to the Manchester Guardian, "The Italian programme is to restrict importers to a percentage (from 10 per cent to 35 per cent) of a basic figure, permitting additional imports only when offset by exports to the same country. Import of a number of commodities is forbidden outright."(*op.cit.*). Another article published in the Manchester Guardian, on the subject of the lira's exchange rate regime argued that it could no longer be considered a Gold Bloc currency by the turn of 1934/35 as it, "restricted imports from all countries gold block associates equally with the rest, and ceased selling gold at anything like the official price in lire."[278].

By early 1935 the US had approached France on the question of a possible stabilisation. By then the dollar had been *de facto* stabilised although the President was to retain the faculty to devalue the dollar further to 50% of its former gold parity. It may also be that the US approach was not entirely disinterested as it was more advantageous to secure a managed stabilisation/devaluation along with dismantling of some trade barriers, as a *quid pro quo*, than a continuation of the relatively anarchic and protectionist currency and trade environment which had existed since the US devaluation. This would suggest that Cordell

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[275] see Manchester Guardian, 29/7/35, R.I.I.A..

[276] see Manchester Guardian, 7/3/35, R.I.I.A..

[277] see Manchester Guardian, 11/3/35, R.I.I.A..

[278] see Manchester Guardian, 28/3/36, R.I.I.A.

Hull's more liberal and internationalist views might have been in the ascendant. One should also note that since the dollar gold price had been stabilized in January 1934 deposits had become more attractive, and the uncertainty surrounding the Gold Bloc led to a gold inflow into the US which allowed a relaxation of monetary policy which assisted in the economic recovery.[279]

However, the French were to adopt an understandably cautious, given past precedent, and wary attitude to US approaches on stabilisation and the French would be particularly concerned not to make anything public so as not to tie the British government's hands,[280] given the unpopularity of the gold standard in the UK.

The US approach had also been prompted by the *de facto* relative exchange stability which had prevailed for sometime. The US would agree not to make debts and former parities preconditions of negotiations. French policy-makers would be instructed to continue discussions with the US whilst also sounding-out the British. However, the weakness of sterling in March 1935 was to prove more immediately crucial and would really signal the demise of the Gold Bloc. After the Belgian devaluation the Gold Bloc became but a holding operation until an international currency stabilisation/devaluation agreement could be reached.

The weakness of sterling, which superficially might appear beneficial to the Gold Bloc currencies, demonstrated the hopelessness of their task, as it would mean further bouts of deflation. A policy which was beginning to reach the limits of acceptability in democracies. In France expenditure reductions were made by decree, parliament agreeing to surrender its prerogative to approve and amend financial measures by investing the executive with a decree-making mandate. This exonerated parliament from sharing the blame for unpopular measures and would allow government to by-pass the obstructive coalition of interest groups and parties represented in parliament.

THE BELGIAN DEVALUATION:

In Belgium the industrial sector had increasingly, *de facto*, fallen into the hands of the banks, as a result of defaulted/non-performing loans contracted during the recession. This was, in

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[279] see Eichengreen Golden Fetters, p.345-346.

[280] see the letter from Monick to this effect.

turn, threatening the financial health of the entire Belgian banking sector. In the circumstances interest rates could not be raised to defend the currency because of its potential domestic impact, particularly on the domestic banking sector,- devaluation was the only way out.[281]

In Belgium there had been an increasingly vocal and articulate school of economists, centred on Louvain, which advocated devaluation. As we have seen Belgium was a particularly open-economy[282] keen not to jeopardise its trade with the UK and other non-Gold Bloc states. The looming Belgian banking crisis and depression in the industrial sector prompted a last attempt by Belgian prime minister Theunis to try and break the effective deadlock which characterised efforts at trade co-operation and revival within the Gold Bloc, though in many ways his visit to Paris in mid-March appears more of a "*visite de courtoisie*" and certainly it is clear from a French perspective that France had no illusions about the outcome: "Belgium would abandon gold."

Ahead of this meeting an article published in Le Temps, realising the urgency of the situation and still holding out against devaluation, suggested that the authorities should just ignore the MFN clause in order to try and increase trade, particularly as a result of the weakening of sterling and there was even a suggestion that a surcharge, as in 1931, be imposed on English goods. However, although French policy-makers, such as Lamoureux, had tried to put the question of derogations from MFN on the agenda of Gold Bloc trade discussions I don't believe that the French authorities seriously contemplated breaking unilaterally with MFN.

Theunis' planned visit to Paris on the 18/3/35 accompanied by his Minister for Foreign Affairs, Hymans, to discuss currency matters and difficulties surrounding quotas with his counter-part Prime Minister Flandin was the cause of some very pessimistic assessments ahead of the talks.

This is evident in a paper entitled, "*La baisse de la livre - ses conséquences - comment réagir.*" The note suggested that the Belgians be urged to hold on for a while longer in order to secure a currency agreement and to sound-out as soon as possible

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[281] Quoting Strohl (1939): "*...les banques, à la suite de l'hypothèque que l'industrie faisait peser sur elles, étaient lourdement immobilisées dans des opérations de commandite, et qu'un resserrement prolongé du crédit leur aurait infligé le coup de grâce, l'ancienne parité fut abandonnée fin mars 1935,*" p.225.

[282] see article by Jenny in Le Temps 11/3/35, R.I.I.A.

Roosevelt on the question. As a *quid pro quo* France would have to get rid of quotas, though not on agricultural products which still had to be protected. Tariffs would have to be maintained. The report is very pessimistic and recognizes that the Gold Bloc had been a failure.[283] A closer look at this report, drafted by the deputy-director of the Political Directorate, (*Direction Politique, le directeur-adjoint*), is of interest as it not only concludes that the Gold Bloc was finished, but also urged that France take the opportunity afforded by the changed attitude to stabilisation in Washington to try and secure either a Tripartite accord or failing that a bilateral Franco-US agreement.

This demonstrates how roles had been reversed. At the London Conference in 1933 it had been the UK which had been more willing than the US; of course the UK had witnessed the benefits of a managed float and an election was looming. The French paper also makes clear that the *quid pro quo* to any agreement would have to be trade liberalisation. It illustrates quite closely the path that would be followed and which we will be examining more closely in the next chapter.

The paper was prepared ahead of Theunis' visit to Paris on the 18th March 1935. Theunis had told the French Ambassador that the reason for his visit was the tremendous impact of the recent weakness of sterling and the strength of opinion favouring devaluation. He would want to know if the Gold Bloc member states and particularly France could compensate Belgium for markets lost because of the continued fall in the exchange value of the "anglo-saxon" currencies, viz., sterling and the dollar. The note concluded its introduction by stating that Theunis' coming visit was a "*visite de courtoisie*" aimed at preparing the French for a change of course, viz., devaluation. In the circumstances the author of the note suggested that this would be a good opportunity to take stock.

The Gold Bloc was about to fall apart under pressure from the economic crisis and anglo-saxon currencies. The Lira which had been stabilised at too high a parity (real exchange rate) had virtually abandoned gold. The Belga was about to abandon gold. Belgium lived-off her trade and had to have outlets. The Swiss and the Dutch were holding on, but by using purely artificial devices, viz., bounties and quotas in the former case and virulent agricultural dumping in the latter. In such circumstances, the author wondered, could the Gold Bloc be in a position to address Theunis' preoccupations? As we shall see

[283] M.F., 11/3/35, B 32 323.

the answer, which was foreshadowed in the introduction, would, in practice be "no!"

In Bruxelles the Gold Bloc had agreed to increase the potential for trade by 10%, i.e., by re-allocating existing unused quotas, this had not been realised. France had offered Belgium concessions worth FRF 90m., or some 8%, and Belgium had only felt able to offer in return concessions worth some FRF 12m. An agreement had however just been reached worth FRF 20m. or 2%. This is clearly derisory given the collapse in both their bilateral trade and their total trade since the depression had begun. The author pointed out that France's agricultural situation precluded any concessions to either the Netherlands or Italy. And in any case Italy was becoming increasingly autarkic in an effort to protect its currency.

The author of the paper suggested that Theunis might propose a renewed attempt at exchanging tariff preferences, although the Belgian delegation had already rejected this at the Bruxelles Conference. According to the author the extensive use of quotas within the Bloc made this difficult anyway and prices in Belgium were too low in certain sectors for French industry to compete if tariffs on Belgian goods were to be reduced. The French Minister of Commerce was adamant on this point and the author of the paper argued that the anglo-saxons would not stand for such a preferential agreement which would most likely lead to retaliation.

Summarising the situation the author of the paper argued that it was too serious to delude oneself, and it was better to recognise that the Gold Bloc did not have a sufficient economic potential and enough complementary markets to be self-sufficient.[284] The Gold Bloc had not been un-useful though, as it had had a psychological impact which had saved the Belgian franc a few months earlier. If speculative pressure against the pound were to continue, which appeared to be the case, the Gold Bloc would fall apart.

It could be said however that the effect of sterling's weakness only substantiated the French argument that an international stabilisation agreement remained fundamental to any currency re-alignment as without one sterling could be allowed to slip. The report, drafted by the deputy-political director, argued that in the existing circumstances it was doubtful whether a preferential trade agreement would suffice.

The author asked, "what would be the effect on the French franc?" It would have a

[284] Quoting the report, *"Mieux vaut reconnaître que le bloc or ne dispose pas d'un potentiel économique suffisant et surtout de marchés assez complémentaires pour se suffire à lui-même."* From, *"La baisse de la livre - ses conséquences - comment réagir."* M.F., 11/3/35, B 32 323.

psychological impact and along with the effects of the economic depression would strengthen the hand of those supporting devaluation and might well lead to the collapse of the franc. This would have disastrous consequences for savings.[285] Other consequences would include misery for pensioners, public servants, and would lead to a disequilibrium of the budget,- though the argument in this regard is often based on the need to raise state spending to compensate for the effect of devaluation. However, one can either argue that it will erode real public sector wages or affect the budget, but not that the total effect will be carried on both counts. The author was of the opinion that devaluation of the franc would bring chaos, as the last fixed anchor broke its moorings.[286]

However, the paper notes that protecting the currency would necessitate appropriate measures. This section of the paper appears aimed at discounting the option, because of the costs in terms of economic isolation which this involved. Such measures would include tightening up quotas, increases in tariffs, increasing licensing taxes (*taxes de licences*). This form of command economy "*économie dirigée*" might forestall for a short-while a further deterioration in the trade balance, but the volume of trade would continue an inexorable fall. France would find itself increasingly veering towards autarky as was the case already for agriculture. The author wondered whether France's industrial structure could withstand this, for since the end of the war and the recovery of the lost provinces France had become a major exporter. Some, according to the author, would say that the slack could be taken up by domestic demand, but that would mean closing off imports which in turn would mean the loss of France's remaining export markets. Given the state of the domestic economy there would be little prospect of domestic demand being able to take-up the slack. "How would France then overcome the economic crisis, unemployment, the budget deficit and how could France afford to pay for her imports?" A figure for imports of FRF 16bn. was quoted.

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[285] This is not only important for investment if one holds to a loanable funds theory of savings and investment, but also the protection of savings is of far greater social relevance in a context in which state welfare provisions, e.g., pensions, remain minimal. Here one should stress that in this context we understand "loanable funds" to be literally that, viz., a stock of investible savings. This is the way it was perceived at the time, not as a flow which is a definition which became current with the ascendancy of keneysianism. This later definition was used to contrast it with liquidity preference which was defined as a stock portfolio adjustment decision.

[286] "*... avec le franc disparaîtra le dernier étalon, la dernière commune mesure c'est la course vers un terme inconnu avec une période de chaos économique et peut-être de désordres sociaux.*" source: "*La baisse de la livre - ses conséquences - comment réagir.*" ibid..

"And what would be the future of the capitalist system if it would bury itself in such restrictions?" This whole section opens the way, in a very continental Cartesian method of reasoning to the obvious option, viz., international monetary stabilisation.

Given the threat which the continued weakness of the anglo-saxon currencies constituted it was essential to secure their stabilisation. The government should do everything in its power to achieve this even if it meant sacrifices. The author recorded that in recent conversations Secretary of State, Cordell Hull, and, Secretary of the Treasury, Morgenthau, had told the French Ambassador in Washington that they were favourably inclined towards monetary stabilisation and would welcome suggestions toward this objective. Cordell Hull had also expressed the wish that the UK be party to any such agreement. However, Morgenthau had stated that for the time being the UK seemed to be intent on deriving all the benefits of stabilisation without actually going ahead, i.e., retaining its freedom of action. The Ambassador, de Laboulaye, had also reported from "well-informed" sources that the US authorities wondered whether it might not be best to seek a bilateral agreement between the dollar and Gold Bloc in order to bring pressure to bear on the UK to join. It would appear that the US was trying to construct by this means a coalition aimed at isolating the UK on the issue.

It was the US which was now sending out feelers on the question of stabilisation, the very country which two years before had effectively scuppered such an initiative, when Roosevelt had declared his preference for a commodity dollar standard, "*étalon marchandise*." The stabilisation agreement mooted would have created an exchange support fund with a mechanism to review the situation when, and if, the fund ran out. The author of the note wondered whether the attitude of the US had altered enough to make such a scheme feasible. It was not impossible, but the answer could not be established through conjecture, only Roosevelt himself could give an answer. The author of the paper characterised the UK's stance as generally opposed to a stabilisation agreement. Chamberlain had just declared that sterling would have to find its own level. However, the author concluded that this was dictated by expediency and the weakness of sterling. In reality it might well be that sterling weakness, buffeted by speculative flows, would make the City amenable to approaches from the Bank of France and the Fed. It would be hard to imagine that the British government which had been favourable to such a proposal in 1933 should veto it now if Roosevelt were to give the necessary assurances. However, it was clear that securing British approval would first of all require US co-operation. This had also been the case at the London Conference.

How should France approach the US? The author pointed out that the US held a position which was intermediary between France and the UK, the British position being that trade should first pick up and stabilisation follow, whilst the French opinion was that stabilisation should precede trade revival of which it would be a precondition. The position in Washington seemed to incline towards simultaneous suppression of exchange fluctuations and impediments to trade. However, France could not expect that any suggested stabilisation would meet with approval unless accompanied by concrete proposals to eliminate trade barriers, both concepts being clearly linked, particularly in the mind of the US Secretary of State Cordell Hull.

According to the author of the note, Herriot had, in 1933, proposed the formation of a club of countries maintaining free trade "*le club du fair play*" which would have committed states to ban all dumping, either social or monetary. The monetary proposal was enthusiastically welcomed, however when it was asked what would be the counter-part, Herriot, constrained by narrow negotiating instructions, could only offer a preferential tariff. This had proved insufficient for the US. The author concluded that it was a mistake not to have pursued this effort.

In order to restore stable currencies and trading relations quotas, which were a response to abnormal conditions, needed to be abolished. The French government should be aware of this, as any misunderstanding would only lead to renewed failure.

The author alluded to the fact that quotas constituted an impediment to free trade and, hence, to stable currencies. A country whose currency was weak because of a deficit on trade account needed to redress this by finding an outlet for its exports, this could not be found in a quota regime. A false equilibrium was thereby maintained. The author warned, though, that the abolition of quotas would have to be undertaken with due regard for the French economy,- which of course was the reason they were introduced in the first place!

It is important to realise that quotas and so-called exchange dumping were symptoms of economic depression and not in themselves causal.[287] The major cause of the depth of

[287] Quoting Drummond (1981), "We are often told that in the 1930s there was a great deal of "competitive devaluation." The literature suggests that country after country depreciated its currency so as to win a competitive advantage. It is never clear, however, which countries are supposed to have done this evil thing.

the inter-war economic depression was due to the lack of fiscal stabilisers or accommodation which set the world economy on a perverse and self-reinforcing deflationary spiral following a set of original shocks,- whether they be credit deflation and falling money supply, or a drop in world commodity prices,- in many cases this would be compounded by over-valued fixed exchange rates that lent an imported deflationary twist.

According to the plan, envisaged by the author of the note, quotas should be relaxed *vis-à-vis* countries which abolished all exchange dumping and foreign exchange controls. In case the UK did not participate France would maintain quotas against her. The abolition of quotas would have to proceed in stages. Agriculture would probably still need protection, both for political reasons and because of the nature of the commodity. At first stabilisation and trade revival should benefit industry, whilst agriculture which suffered from overproduction would require other means to deal with it.[288] France would still maintain its tariffs and these would have to be adjusted to take account of the new situation. This would mean that some tariffs would have to rise, and quite substantially! The government would have to resist any excessive demands for compensatory protection.

Though tariffication is obviously a welcome alternative to quotas, raising them betrays a singular lack of ambition for this programme of liberalisation. The author did not mention MFN and how this process would square with the Empire Preference System. However, the author underlined the fact that the "anglo-saxons" perceived quotas and not tariffs as the main impediment to trade and only if these were abolished could one expect them to agree to

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Clearly neither Britain nor the Empire countries did so. Devaluations, when they occurred were imposed by market forces." p.256. This is a view shared largely by Professor Susan Strange,- with which I wholly concur. In fact it might be argued that this view was propounded by the likes of Cordell Hull in order to secure a post Second World War liberal free trade system which would be as much in the US's economic and political interests as free trade had been in the UK's during the nineteenth-century. It may also be argued that this policy was aimed at avoiding the erection of currency blocs so that the US could reap the benefits derived from having a hegemonial currency, financial and trade status.

The US, "deliberately depreciated its currency against gold, thus winning an advantage in world trade even though its balance of payments was already in surplus on current account and even though it had virtually ceased to lend abroad"... "When we are told that the 1930s was a decade of competitive devaluation, in large part we are hearing an echo of American economists' guilt: it was their country, not Britain, that deliberately destabilized the set of exchange rates." *op.cit.*, p.257.

One should, however, note that though the US is blamed for its unfortunate unilateral action both in the trade field,- viz., 1922 Fordney-McCumber tariff act and the 1930 Hawley-Smoot tariff legislation,- and in the monetary field. The UK policy of Empire Preference initiated at the Ottawa conference in 1932 was not a helpful gesture ahead of the planned international economic conference.

[288] The reasoning here is somewhat confused, whilst protection might well protect the incomes of the agricultural sector it would do nothing to resolve the problem of over-production,- quite the contrary.

stabilise their currencies. This plan resembles the proposal made under Laval to reduce impediments to trade in return for an agreement to stabilise currencies.[289]

The author concluded his analysis arguing that his study demonstrated that measures which the Gold Bloc could put together to deal with the crisis would be inadequate; that whatever France might do the continued weakness of the anglo-saxon currencies would have grave consequences for France; that this might be a good time to stabilise currencies and was certainly the last opportunity to do so as the Gold Bloc was falling apart; that the abolition of quotas was a precondition for the anglo-saxons and that this would mean a process of tariffication.

The author pointed out that such a policy would signify a change in the course adopted over the past few years, but that France would nonetheless be remaining faithful to the line which it had adopted at the 1933 London World Economic Conference. This is the view that I have also taken,- the Tripartite Agreement would largely conform to French objectives as developed in London.

It is interesting to note that this paper drafted on 11/3/35 should have already condemned the Gold Bloc, though it would still linger on for a year and-a-half until the French devaluation of September 1936. This suggests that France might have devalued earlier had an international agreement been possible. As we will demonstrate in chapter eight French governments would be conducting informal discussions on this very issue with the US and British governments throughout 1935. This is substantiated by Drummond's research.[290]

It is also interesting to note the very pessimistic tone of this paper compared to the campaign against devaluation being waged at the time in the media and by leading political figures,[291] who would have had access to these gloomy prognoses.

The author concluded his note by remarking that the course he had outlined would

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[289] see Gignoux (1943).

[290] Bonnet proposed on 17th September 1935 to, "negotiate wide-ranging trade agreements with any countries that would stabilize their exchanges - either at the existing parities or perhaps plus or minus 10 per cent." Drummond (1981) p.193. This substantiates our contention that the French authorities had been negotiating since at least 1935 to secure an exchange stabilisation accord. Therefore, when Vincent Auriol presented the exchange rate adjustment (devaluation) as being in accordance with French policy since the World Economic Conference he had a point.

[291] see chapter seven of this thesis.

be difficult and invite opposition, but that it was the only means to restore order and economic prosperity. In his view if the government shared his analysis it should lay this before Theunis and attempt to convince him to wait until a negotiated agreement could be reached. The second measure would be to discuss urgently these proposals with Roosevelt in person. De Laboulaye should question the President and ask him whether he would be favourable to such a project and whether he would allow representatives of both countries to work on such a proposal.

Another note prepared for the Minister by the Director of the Treasury section at the Ministry of Finance (*le Directeur du Mouvement Général des Fonds*) on the question of the Gold Bloc and Theunis' arrival in Paris,[292] is very similar in content and argument as the longer report which we have just analyzed and may well be a shorter briefing prepared specifically for the Minister. This paper recognises that Italy was already *de facto* outside the Bloc. And that the Bloc's only chance for survival was essentially to bring the UK and US within it. To do so would require measures aimed at trade liberalisation and therefore tariffication. Tariff preferences could be withdrawn should the agreement fall apart. The problem of MFN is again not addressed here. Though it would be of far less importance if the three trading blocs were party to the agreement. However, he concluded that Theunis' arrival in Paris would mean that the Gold Bloc could no longer be made of appearances, but must have some substance. This could not be realised unless the UK and US were effectively a party to it. Cordell Hull's most recent overtures afforded the opportunity to present a programme aimed at realising such an objective with both the UK and US. The Director concluded that failure would not have dramatic consequences as it would serve to justify a policy of rigorous economic isolation which would be the inevitable consequence of a collapse of the Gold Bloc. This last sentence, which was underlined in pencil in the original (one guesses by a sceptical reader), is surely a gross miscalculation for the consequences of economic isolation would compound the existing economic depression as well as isolate France politically.

In the following days a telegram was sent to the Washington Embassy, on 14/3/35, requesting that Roosevelt be approached on the question of monetary stabilisation as the franc was becoming over-valued. This was subsequent to prior conversations held with Cordell

[292] see M.F., 11/3/35, B 32 323.

Hull and Morgenthau. This illustrates the extent to which Roosevelt's behaviour in London had in a sense undermined the negotiating ability of his own closest advisers,- with such a mercurial character only his own say-so would count. The telegram again sounds a pessimistic note on the Gold Bloc. It rejects a forum such as a world economic conference, favouring discussions between French, US, and UK delegates. It also suggested that monetary stabilisation could be accompanied by a loosening of impediments to trade, an obvious bargaining chip to entice the US.

Another paper, dated 15/3/35 just prior to Theunis' arrival, which discussed measures which could be granted to Belgium to keep her within the Gold Bloc indicated that these were virtually nil. Belgium's quota allocation could only be increased to the extent to which other nations had underfulfilled their own quotas. And in this regard Belgian imports from France would also have to be taken into consideration. The paper argued that extra quota concessions conceded had not been fully reciprocated, and agriculture remained too sensitive an area. MFN remained a stumbling bloc, as did the agreement of 1st July 1934 with the UK which effectively precluded raising Belgian quotas, as any quotas granted to Belgium might prompt demands for reciprocal arrangements for the UK.[293] The note raised the possibility of increasing Belgium's quotas by 10%. It suggested that this would not be enough to elicit complaints from other nations. However, Belgium would have to reciprocate.

Here we have the *reductio ad absurdum*, the suggestion, in effect, that a trading bloc be created within the shell of a similar accord which had failed. However, the paper points out that agricultural and industrial interests might object and so might other nations. Within the confines of the Gold Bloc the paper suggested that quotas be replaced by tariffication, albeit at an increased level! The paper records that this solution appeared to meet with the approval of the Ministry of Finance. It goes on to argue that this could prove unacceptable to other countries within the Bloc because of divergent production costs. This would be the case in particular for Switzerland where production costs were very high and an increase in tariffs might exclude Swiss exports altogether. The *résumé* of discussions held at the "*Commission des Accords Commerciaux*" (Committee for Trade Agreements) states that though the trade agreement of 29th March 1934 with Switzerland hampered France's ability

[293] From files at the Ministry of Finance B 32 323.

to alter tariff schedules (a condition which Switzerland had insisted upon) France had as a counter-part secured guarantees which had maintained a positive balance on exports to Switzerland in 1934 of 700m. French francs. A meeting of the Committee for commercial agreements on 15/3/35 rejected the tariffication idea and extended the 10% reciprocal quota concessions accorded to Belgium to all Gold Bloc countries bordering on France,[294] thus excluding Poland. These concessions would be reciprocal. The paper records that the Agricultural Department and the Directorate for Commercial and Industrial Affairs had expressed reservations on this issue. The Committee also suggested that these should eventually be extended to countries agreeing to stabilise their currencies. Though these conclusions appear to be appended to a note drafted on 23rd May I am quite certain that it actually forms part of the *résumé* of discussions held at the *Commission des Accords Commerciaux*. It is not clear whether these concessions actually came into effect given the subsequent Belgian devaluation.

The conclusions of the Committee for Commercial Agreements are very gloomy and the whole zero-sum approach is entirely mercantilist. On the question of increasing the allocation of unused quotas it was argued that at this time of the year it was not possible to evaluate these with any precision and that in any case any discretionary benefits which France could offer Belgium in this regard had already been extended under the 25th February agreement. Under this agreement supplementary quotas were extended to Belgium worth FRF 10m. and France had, during the course of 1935, agreed to extend a further FRF 13.1m. in supplementary quotas to Belgium. This was equivalent to the difference between the extra quota concessions made under the 25th February agreement and the FRF 23m. + 10% value of orders which Belgium had agreed to place with France. The paper argues that it would therefore be impossible to raise this at this time of year.

As far as abolishing quotas which particularly affected Belgium, such as those on leather and skins, glass, and bottled vegetables, these were the very areas in which French industry had been lobbying for a tightening-up of quotas. It was therefore out of the question that these be abolished.

Increasing Belgium's quotas within the overall total would fall foul of such agreements as the Anglo-French commercial accord of 1st July 1934 which guaranteed the

[294] see files at the Ministry of Finance B 32 323.

UK a fixed proportion of France's quotas. Raising Belgium's quota would encounter the same difficulties. In the agricultural sector quotas in Belgium's favour could not be raised as it was used for trans-shipment and would provide a loophole for third country imports. This could not therefore be considered.

The Committee went-on to consider raising Belgium's quota by 10% on the border. This could be worth some FRF 100m. The paper suggested that this could escape the strictures of MFN. However, this is rather hard to imagine.[295] The Committee however stated that this would have to be reciprocated, though recognising that a similar offer from Belgium would not be worth as much, as Belgium did not have such an extensive quota regime. The advantage of such a scheme was that it would not require parliamentary approval. However, the representatives of both the Ministry of Agriculture and the Directorate for Commercial and Industrial Affairs expressed reservations. Increased imports into France would have a detrimental impact on French industry and agriculture, and provoke opposition from third parties, who would perceive the scheme as a means of allocating to Belgium disguised quota preferences.

The Committee therefore studied two alternatives, 1) preferential customs duties "*droits de douane préférentiels*"; and, 2) refunds on customs duties. The Committee argued that preferential customs treatment on Belgian goods could hardly be justified within the Gold Bloc as Belgium already had the lowest price level and real exchange rate, and that such a scheme would inevitably be a cause of recriminations. This would be even more so with import duty refunds which would be used to stimulate bilateral export trade. Both would require parliamentary approval.

The last paragraph concerned a recent request by the Prime Minister to the Foreign Ministry concerning the possibility of revoking all agreements regulating the employment of foreign labour in France. France could offer Belgium an exemption from such a measure which would benefit the significant number of Belgians working in the North of France. The report of the Committee ends by stating that such a concession would not be insignificant.

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[295] This is how Eichengreen (Golden Fetters, p.362 footnote 22) assesses the French offer aimed at forestalling Belgian devaluation, "In fact, the French offered to increase their quotas on imports from Belgium by 100 million francs, but this was only a fraction of the additional 800 million francs worth of export revenues that Belgian exporters figured defense of the currency required"..."The French Finance Ministry's more ambitious plan to convert its quotas to import duties, and thereby permit Belgium to increase its sales, was made contingent on foreign reciprocation, and therefore proved impossible to arrange in the short run."

What is remarkable in this digest of discussions held just a few days before Theunis's arrival is the unwillingness to make any concessions and the highly autarkic tone of some of the suggestions. Both this note and the note prepared by the "*Directeur du Mouvement Général des Fonds*"[296] suggest that some policy-makers were even willing to consider measures which bore dangerously close parallels to Nazi Germany's economic policies, "and all this in the pursuit of economic liberalism and fixed exchange rates!"

Shortly before the Belgian devaluation the Director of the Paris Mint (*Directeur des Monnaies*) wrote to the Minister of Finance, following a trip to Bruxelles, warning that the Belgians might soon devalue followed by the Dutch and Swiss. This would have a terrible effect on France's trade. The reason the Belgians would devalue would be, in part, disappointment at the failure of the Gold Bloc to lead to any real economic co-operation.

The Director of the Mint reported that in the last few months, and particularly since sterling had weakened, partisans of devaluation had made considerable progress in Belgium. He alluded to the fact that major dailies such as, Le Soir, were virtually openly campaigning in favour. Belgian Prime Minister Theunis still supported stable money, but his trip to Paris appeared to be the last trick up his sleeve. Belgium would leave the Gold Bloc if an immediate effort were not made to create real economic solidarity. So far co-operation had been limited to well meaning statements of intent, but no real effort. This had left the Belgians very disappointed and annoyed. Should circumstances not change they would abandon the gold standard. In this event Theunis would resign to be replaced by Francqui who would *de facto* peg the Belgian franc to sterling. As it turned-out van Zeeland became Prime Minister. The Director of the Mint expected that this turn of events would occur rapidly so that the Exhibition planned on the 27th April would be poised to reap some of the economic benefits.

If this were to occur the Dutch would be expected to follow suit as well as the Swiss. The impact on France would be significant as these countries accounted for a third of France's remaining exports (the total figure given for exports being FRF 12bn.). In the circumstances, judging from the effect which sterling devaluation had had, the effect of devaluation could cost France half of her exports to these countries. It would also have an impact on France's colonies (here Morocco is mentioned in brackets) it would affect the

[296] see above, M.F., B 32 323, 11/3/35.

French tourist trade, and generate losses on assets denominated in Belgian and Swiss francs, and the Dutch guilder. The overall effect on France's balance of payments could amount to at least some FRF 4bn., of which half would be accounted for in the balance with Belgium.

At this time a rather ingenious plan was suggested which would have marked a real attempt at intra-Bloc co-operation, though it probably would never have held for any length of time in a bloc which was so dependent on outside trade and whose trade was complementary in certain important sectors, such as agriculture, which were too politically sensitive. Furthermore, the Bloc could never have got round the problem of buying within the world's dearest market. The draft plan which would have a been a step towards creating an integrated currency and trading bloc, also addressed the perennial problem of the asymmetry of the balance of payments adjustment mechanism. The plan actually closely resembles Keynes' later Bancor plan, which one day may still merit being disinterred.

The plan contained in the note entitled, "*Le Franc et le Bloc or, résumé*," and, "*Le Franc et le Bloc or*,"[297] proposed that currencies be supported by contributions of 1 *milliard* each (secured by gold) by the Swiss, Dutch, Belgian and French central banks to a clearing to support their respective exchanges. The paper states that the clearing should not be located in Paris so as not to create the impression that it was dictated by a French desire to exercise financial hegemony. There would be no currency risk for the lender, as currency borrowed (lent) would be borrowed in the creditor countries' currency and charged at 1% above the discount rate prevailing in the lending country. This would contribute to the adjustment mechanism as to avoid losses the debtor central bank would have to maintain a discount rate above that at which it had borrowed. In return the creditor country would have to decrease its tariffs by 10%. This would lead to greater monetary and economic integration. The real adjustment would be made by the creditor country, which by definition (given the prevailing orthodoxy) would be the most prosperous and the most able to bear the cost, as it would open its market to imports from the debtor member states which ran a deficit against the proposed clearing. The creditor country should also allow the borrowing country to tap its capital market for an issue of up to 1 *milliard*. The debtor country would thus avoid depleting its reserves. Such an agreement would limit any one country to a maximum assistance of FRF 3bn. before the agreement came up for review. The paper

[297] see, "*Le franc et le Bloc or, résumé*," and, "*Le Franc et le Bloc or*," 13/3/35, M.F., B 32 323.

suggested that were the individual country limits breached then repayments of say 10% or FRF 100m. should take effect. Should the creditor country choose not to reduce its tariffs by 10% then 10% of its tariff product should be ear-marked to reduce the borrowing country's debt and the latter should use an equivalent sum to subsidise its exports. The paper recognises that the country effectively pledged to give support under such a scheme would in effect be France which had the least unfavourable balance of trade within the Bloc.[296]

This ingenious plan was aimed at preventing a collapse of the Gold Bloc and the ensuing prejudice to France's trade. It was hoped that such a system might attract other countries, the hope was particularly expressed that Great Britain might wish to join and perhaps Spain. The hope that the UK might wish to join was hopelessly unrealistic, as it would have implied the abandonment of the Imperial Preference system and the UK's new-found currency autonomy. The paper also argued that the gold standard regime within the Gold Bloc was destabilising. Gold flows were not equilibrating, but rather caused further speculation against the country losing gold. The paper also pointed-out that Gold Bloc currencies which did receive gold as a result of speculative flight from fellow Gold Bloc central banks, e.g., France in 1935, would themselves be subject to speculative pressure because the cohesiveness of the Bloc was perceived as a whole. A run on one currency meant uncertainty for all. Any gold flowing into France would be merely in transit before being shipped to London and New York, as a result of currency support operations. The paper argued that if Belgium were to go off gold this would inevitably drag down the Swiss franc and Dutch guilder and would have such an impact on France's trade and employment that even if it had gold reserves of 100bn. French francs this would not suffice. France would have to abandon gold under the strain of financial and social pressures.

The paper attempted to quantify some of the implications of the plan and alternatives. It pointed out that the maximum exposure of FRF 3bn., which would be secured on gold, would be a fraction of the FRF 10bn. of sterling purchases (without exchange guarantee) in the period 1928-31. Sterling had only accounted for a quarter of France's exports, whilst the Gold Bloc states concerned, namely Belgium, Switzerland and the Netherlands accounted for a third. Opening the Paris capital market to a few FRF billion in sovereign (debt) loans would be far less risky than guaranteeing Czech and Austrian loans as France had done in

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[296] see, op.cit., p.4..

the past. The customs duties concessions might be worth some FRF 400m. in lost revenue, however this paled into insignificance compared to potential losses of FRF 4bn. if the Gold Bloc fell apart. A Gold Bloc collapse would double the rate of unemployment and would reduce fiscal revenues by more than FRF 500m. In the long term France could expect to gain from such an agreement as she ran a surplus against the Gold Bloc. The author argued that France would obtain reduced customs duties on exports worth 3.8bn. French francs, whilst France would be reducing duties on imports worth 2.7bn. French francs. Finally, such an agreement could be expected to attract the UK which would not want to risk capital migrating towards this market and would benefit from the economic advantages that it promised. The paper argued that the UK would be more secure within the confines of such an agreement than with a floating exchange rate and all the risks that this implied.

However, whilst this paper is by far the most imaginative paper to have emanated from the Ministry of Finance during the whole period under review, it still overestimates France's importance to the UK and fails to recognise the very real benefits which the UK derived from a floating exchange rate.

The Financial News was apprehensive about the future of the belga, should the Franco-Belgian negotiations come to naught, and suggested that in such circumstances the belga might join the Sterling Bloc. As we have seen the confidential French assessment was, if anything, more pessimistic cf., "*La baisse de la Livre*," (*vide supra*). Belgian devaluation was expected because of the recent weakness of sterling and the additional adjustment costs which this imposed on Belgium, as well as Belgian domestic opinion which favoured devaluation and the failure of the Gold Bloc to increase intra-Bloc trade. The author of the paper argued that the Gold Bloc was finished and France should reach an agreement with the "anglo-saxon" countries before it was too late and the franc fell. The *Directeur politique* did not hide his apprehensions for the Swiss franc and the Dutch guilder arguing that both countries were holding by means of artificial methods, tariffs and bounties in the case of Switzerland and exacerbated agricultural dumping practised by the Netherlands.

The uncertainty surrounding the Swiss franc was compounded by a referendum which was to be held on the 2nd June. This had been organised by the socialists and opponents of further deflation. It was felt that support for the referendum would inevitably imply devaluation. The issues were, 1) the maintenance of the purchasing power of consumers by preventing a reduction in wages; 2) securing prices against a further fall; 3) the provision of adequate employment; 4) support for farmers by relieving the burden of their debt; 5) support to industrial firms which got into difficulties because of the burden of their debts; 6) utilisation of the capital resources of the country to stimulate exports and tourist traffic; 7) regulation of the capital market and control of the outflow of capital; 8) control of cartels and trusts.[299] It is hardly surprising, given this wish-list and particularly point 7, which was really the icing on the cake, that gold losses ahead of the referendum amounted to some 10% of Switzerland's reserves. However, the Swiss electorate displaying a substantial dose of Calvinist probity rejected the referendum.[300]

Ahead of Theunis' Paris visit the Manchester Guardian (16/3/35) reported that the lira was at a permanent discount of 6% and that the belga was also under pressure. The Swiss as well as the Belgian economy were affected by sterling's weakness and the undervalued dollar as both countries were dependent on trade and tourism. The British had a steel tariff, which did not help Belgian industry either.[301]

Eichengreen states that the immediate catalyst for Belgium's decision was, "A British government decision to limit steel imports, thereby blockading one of Belgian industry's principal export markets, was the immediate occasion for the crisis."[302]

As had been expected Theunis' mission proved a failure. France did offer to make a loan of 1bn. Belgian francs on condition that it did not introduce exchange controls.[303] However, capital flight had already resulted in a loss of Belgian reserves of 1bn. Belgian francs[304] and as we have seen the Belgian authorities were particularly concerned to implement measures to boost their flagging economy and, more immediately, to alleviate the strain which deflation was imposing on the Belgian financial sector.[305] The Survey of

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[299] source: Financial News, 14/3/35.

[300] source: Manchester Guardian, 7/11/35.

[301] source: The Times, 26/3/35.

[302] Golden Fetters, pp.361-362.

[303] Kindleberger (1984) p.396.

[304] see Kindleberger (1984).

[305] see Bussière (1988); & Eichengreen Golden Fetters.

International Affairs[306] mentions that the French government had offered a loan of 3bn. Belgian francs at 3.5% and that in the parliamentary debate on devaluation both Jaspar and Theunis who were now in the opposition "made much of the offer." However, as the author of the Survey pointed out the Government spokesman, "...could retort, however, that a devaluation had been rendered imperative, not by any technical weakness of the belga or lack of liquidity at the National Bank, but by much profounder forces,- in brief, by the practical inability to proceed with the measures of deflation, including wage-cuts, that were necessary if the former gold parity was to be maintained."[307]

Le Temps reported that on 25th March the Theunis government, just before resigning, introduced measures aimed at stemming capital flight and prohibited gold exports, i.e., it introduced exchange controls on capital account. Excepted from these measures were payments for merchandise. On the 31st March, *Le Moniteur Belge*, published the new monetary law of 30th March 1935 of the van Zeeland government. This suspended the provisions of the monetary stabilisation law of 25th october 1926 governing the exchange value of the belga. The law allowed the King to set a new parity at a maximum of 75% and a minimum of 70% of its previous parity. The law also empowered the King to create an exchange stabilisation fund. Article four stipulated that the currency would be legal tender despite any clauses to the contrary, viz., gold or other indexation clauses. The law provided for the revaluation of the Belgian National Bank's gold stock at 75% of its previous parity,- accounting profits being credited to the Treasury. These profits could either be credited to the account of an exchange equalisation fund or be used to support a policy of domestic economic revival. A decree published on the 31st March set a gold purchase price for the belga of 0.150632 gms. of fine gold. This was the rate at which the newly created Exchange Equalisation Account would buy and sell gold, excluding usual costs. Though Belgium had devalued and suspended gold convertibility it had chosen a fixed gold peg. This would be the rate at which the Belgian franc would return to gold convertibility exactly a year later.

It is interesting to note, given French apprehensions, that the Belgian cabinet did discuss joining the sterling area to avoid any retaliatory action by the UK. But, the Governor of the central bank opposed this as it suggested a permanent departure from gold. Therefore

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[306] see Hodson (1935), "World Economic Affairs," in, Survey of International Affairs, 1934, p.33.

[307] Survey of International Affairs, p.33.

an exchange equalisation account was set up to peg the belga against Gold Bloc currencies.[308]

The belga had been effectively devalued 28%. The revaluation of the central banks gold stock realised a windfall gain of 3.7bn. belgian francs on a total gold stock worth 11.292bn. Belgian francs using the 1926 gold value.[309]

Eichengreen notes that the 28% rate of devaluation was exactly the figure calculated by the Institute of Economic Sciences at the University of Louvain needed to restore Belgium's competitive position. It was hoped that abiding by this would avoid retaliation.

The Financial News reported that France had threatened to raise duties against Belgian imports following devaluation, whilst the Belgians accused the French of failing to open their markets to Belgian exports. The French were also angry at Belgium's refusal of the proffered loan. However, by the 1st May the Financial News was reporting that the situation in Belgium was improving and gold beginning to flow back. The Manchester Guardian (9/4/35) recorded that Belgian policy was to encourage industry to raise prices, thus reducing the strain on balance sheets and avoiding charges of exchange dumping.

Quoting Eichengreen on policies pursued in Belgium and their effects, "Another factor, in addition to the evolution of relative prices, that contributed to the stagnation of exports was the government's policy of preventing "exchange dumping" in order to minimize the danger of French commercial retaliation. The Belgian government pledged that exporters would not reduce their foreign currency prices if foreign governments promised to apply no new barriers against Belgian goods. An export licensing system was developed to gather data on export prices and enforce the agreement."[310]

Eichengreen argues that the Belgian *Fonds de Rentes* created with a capitalisation of 800 million francs with part of the profits realised on the central bank's revalued gold reserves supported the balance sheet of banks through its purchases, lowered interest rates, "and expanded the domestic credit supply."[311] Additionally, "An Institute of Rediscount and Guarantee was created to extend loans to industrial, commercial, and agricultural

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[308] see Eichengreen Golden Fetters, p.363.

[309] see, B.F., *Dévaluation Monnaies* III, 4 N 383, *"La Dévaluation Belge."*

[310] Golden Fetters, p.364, footnote 31.

[311] Golden Fetters, p.363.

enterprises. No limit was placed on its right to rediscount at the central bank." As a result of this accommodation the money supply rose sharply. Quoting Eichengreen again, "In Belgium, devaluation prompted rapid monetary expansion; the economy experienced a vigorous recovery led by domestic demand."[312]

In fact Eichengreen contrasts two models of recovery among countries which abandoned gold. Those who devalued and pursued vigorous credit expansion, followed by a rapid rise in industrial production and economic activity. In this model as prices rose exports were not as important. In fact in Belgium the deficit on current account widened, but this was more than offset by capital inflows.[313] The second more cautious policy is illustrated by the Czech-Slovak devaluation where a more prudent policy was pursued and prices rose less, as a result the real exchange rate depreciation was greater and recovery was more export led. Quoting Eichengreen, "In Czechoslovakia, a more conservative monetary policy was pursued; recovery was slower and more dependent on export markets."[314]

The Times reported that Belgium used the opportunity of the following BIS meeting, in Basle on 7/4/35, to explain the reasons for its devaluation. However, the remaining three Gold Bloc states, represented respectively by Tannery, Trip and Bachmann reaffirmed their determination to remain on gold.

One reason that the remaining Gold Bloc states made this commitment was that the whole edifice was clearly under threat. In the month 18/3/35-15/4/35 the Netherlands central bank and the Swiss National bank had incurred gold losses. Over this period the gold cover ratio in the Netherlands had fallen from 80% to 70% of sight liabilities and the discount rate had been raised in two steps from 2.5% to 4.5%. The gold cover ratio in Switzerland had fallen from 95% to 89% of sight liabilities.[315] In France Flandin tried to bolster the franc by declaring[316] that gold francs would be issued (i.e., a return to the gold standard proper). The Swiss francs was particularly under strain with the controversial referendum coming up. In early April the Manchester Guardian gave the following figures for forward discounts

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[312] op.cit., p.358.

[313] op.cit., p.364.

[314] op.cit., p.358.

[315] source: B.F., *Délibérations du Conseil Général, séance du 25/4/35.*

[316] see, Financial News, 5/4/35.

against Gold Bloc currencies: 3% for the franc; 7% for the Dutch guilder and 15% against the Swiss franc.

In fact the Swiss authorities had approached the Bank of France to secure the early repayment of a French railway loan floated on the Swiss market. Fournier, of the Bank of France, had visited the Swiss National Bank on 18/4/35 to discuss this, as well as the conduct of Swiss monetary policy. He managed to convince the Swiss authorities to abandon their attempt to bolster the Swiss franc on the forward market, which was counter-productive and only fuelled speculation. However, Fournier failed to convince the Swiss National bank to raise its discount rate and to control credit.

The question of refunding the railway loan encountered difficulties. Fournier had argued that this would require the co-operation of French para-statal organisations to buy the outstanding bonds and that this would take time. Instead he suggested that the bonds be used as collateral for a credit, which could be offered promptly. However, the Swiss National Bank could only accept this if the credit were denominated in Swiss francs, to avoid any potential exchange losses. This condition was unacceptable to the Bank of France as it would then be carrying the exchange risk. In the circumstances the Swiss indicated their preference for an early repayment of the railway bonds.[317]

The minutes of the *conseil général* of the Bank of France of 2/5/35 record that the Swiss National Bank gold reserves had continued to fall, and were down to 85% of sight liabilities on 30/4/35. However, these minutes record that despite a letter from Fournier reiterating his suggestion that the Swiss monetary authorities raise their discount rate this still had not taken place. Bachmann, the President of the Swiss National Bank, renewed his request for an early repayment of the French railway loan of 100 million Swiss francs due on 15/3/36. The minutes indicate that the Bank of France would not be willing to consider a piecemeal repurchase programme, but would study the possibility of an early redemption.[318]

The next meeting of the *conseil général* held on 9/5/35 records that the Bank, the Ministry of Finance, the French State railways and the *Caisse des Dépôts et Consignations* were studying the best way of realising the early redemption of the bonds. It is particularly

[317] B.F., *Délibérations du Conseil Général, séance du 25/4/35.*

[318] B.F., *Délibérations du Conseil Général, séance du 2/5/35.*

interesting to note the participation of the *Caisse*.

The *Caisse* would be asked to purchase the long term bonds to fund the operation. As a *quid pro quo* the Bank would agree to make credit facilities available to the *Caisse*, should the need arise. This illustrates the very close relationship existing between these institutions, as well as the use of para-statal bodies to get round the restrictions imposed on the Bank of France's activities and the assets it could acquire through discount and lending operations. In this case had the Bank of France subscribed to a new bond issue by the French state railways to redeem the loan floated in Switzerland, this would have raised a few eye-brows as well as undermined the credit of the Bank.

Although the Governor of the Bank of France felt that in the existing circumstances it was important to demonstrate willingness to assist the Swiss authorities, he nevertheless continued to indicate his preference for a straightforward loan. However, Weber, a director of the Swiss National Bank then in Paris, made it clear that the Swiss preferred early redemption. This reluctance to accept a French franc loan suggests that the Swiss monetary authorities were aware of the possibility of devaluation which would involve the national monetary authority in foreign exchange losses. The Governor of the Bank of France indicated that he would continue the discussions at the next meeting of central bank governors in Basle.[319]

This episode does demonstrate that France was willing to provide assistance, but it illustrates the *ad hoc* nature of the Gold Bloc. There were no automatic facilities (drawing rights or general arrangements to borrow) which could be drawn on at short notice, although as we have seen (*vide supra*) there were limited facilities available through the BIS in conjunction with the Federal Reserve Bank of New York.

One should also note that the exchange difficulties prompted by the departure of Belgium from the Gold Bloc occurred despite very substantial gold reserves held by participating states. France had enough gold to pay for three years imports. It was clearly the domestic untenability both from a social and economic perspective of the Gold Bloc rather than the technical position per se (Belgium had a gold cover of some 60% when it devalued) which was undermining it, as well as the effect of desertions along the way. What is extraordinary was that the Gold Bloc would soldier-on for a further year.

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[319] B.F., *Délibérations du Conseil Général, séance du 9/5/35.*

In chapter eight we aim to demonstrate that France was not unwilling to devalue, but stuck to its 1933 position, viz., that this should fall within the framework of a negotiated stabilisation,- though in 1933 the question of stabilisation revolved around dollar devaluation. However, by sometime in 1935, "stabilisation" when discussed by French policy-makers, had gradually become a euphemism for an internationally agreed devaluation of the franc.

Though France could legitimately worry about anglo-saxon currency instability, particularly the US after Roosevelt's experiment with malign neglect, one cannot escape the impression that France should have jettisoned this doomed Gold Bloc experiment. Practically anything would have been better than a continuation of deflationary policy, which of course was Roosevelt's crucial insight. Paradoxically the pursuit of deflation in the name of economic liberalism would prepare the electoral victory of the anti-capitalist Popular Front.

CONCLUSION:

This chapter has demonstrated that the Gold Bloc, as an economic experiment, was a resounding failure. It lacked ambition from the outset and the economic depression made it virtually impossible to resist calls for continued domestic protection. It seems all along to have been no more than a holding operation, the eventual and reticent adoption of the currency accord at the Bruxelles meeting being a clear illustration of this. Analysis of internal policy documents has shown that French policy-makers by no means shared the optimism evinced in the media as to the viability of France's gold parity. As we shall see (in chapter seven) leading policy-makers such as Germain-Martin were not unwilling to consider an internationally agreed currency stabilisation, i.e., an orderly devaluation of the franc. The difference in emphasis with his stance was that Reynaud urged devaluation even if an agreement could not be reached. Reynaud also advocated accompanying measures, in particular an effort to balance the budget.

The failure to develop a preferential trading area also illustrates the difficulties of liberalisation in a deflationary environment. Though, the Gold Bloc remained too dependent on extra-Bloc trade to risk any unilateral measures which might invite retaliation, and the MFN principle remained a constant stumbling bloc.

In chapter eight we will see that despite France's continued adherence to gold and public statements in support governments were throughout 1935 following up US feelers in favour of stabilisation, viz., devaluation of the French franc. This time it would be the UK which would be most reluctant to enter into any exchange rate commitments, particularly in an election year.

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Document A-3: "*Déclaration des Etats fidèles au régime de l'étalon or*," 3rd July 1933.

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Document A-7: "*Protocole signé par les représentants des Etats adhérents au Bloc or*," 20th October 1934.

Document A-8: "*Projet de note aux gouvernements américain et britannique*," 8th September 1936.

Document A-9: "French Triparatite declaration," 25th September 1936.

Document A-10: "Agreement regulating 24hr. gold guarantee arrangements between British, US, and French monetary authorities," 14th October 1936.

Document A-11: "Extension of 24hr. gold guarantee arrangements to Belgian, Dutch and Swiss monetary authorities," 23rd November 1936.

Document A-12: "US Treasury statement proposing clearing (netting) of gold balances held under ear-mark between central banks party to 24hr. gold guarantee arrangements," 26th January 1937.

Document A-13: "*Note sur l'open market policy,*" 23rd May 1933.

Document A-14: "*Moyen d'action sur le marché monétaire donné à la Banque de France par la Convention du 23 juin 1928,*" 22nd September 1933.

CHAPTER 7

THE DEVALUATION CAMPAIGN

"Notre devoir était de défendre le patrimoine des épargnants. La dévaluation est une faillite. On ne fait faillite que s'il n'y a plus d'espérance d'amélioration. Ce n'était pas le cas en 1934."[1]

In this chapter, which must be seen as complement to chapter five entitled, "The Nature of Financial Orthodoxy," we aim to track the devaluation debate over the period 1934-36. We will make liberal use of the contemporary press in a loosely chronological order, much as Marguerite Perrot (1955) did for her economic and political study of financial opinion in the UK and France. The press cuttings used are from press cuttings files at the Bank of France. It is felt that having adumbrated the underlying theoretical model which informed decision-makers, in chapter five, allowing contemporary commentators such as Frederic Jenny of Le Temps, or, Lucien Romier of Le Figaro speak for themselves will enrich and enliven our study. Furthermore, politicians were very frequent contributors to the discussion of monetary policy in the financial press and a close reading of their contributions should assist in understanding the contemporary policy debate.

The debate over devaluation began in earnest in 1934 when P.Reynaud a prominent figure of the centre-right and member of the *Alliance Démocratique*, future Finance Minister and Prime Minister, began his campaign in favour of devaluation. His speech was delivered in the Chamber of Deputies on 28/6/34, six years to the day since the Poincaré stabilisation. However, he constantly pressed for a so-called devaluation *à froid*, arguing that the worst outcome would be a forced devaluation, *à chaud*, unaccompanied by fiscal measures and supply-side policies, such as lifting of quotas and tariffs. He seems to have proposed a package similar to that introduced under the stewardship of Neville Chamberlain in the UK. As we will see, his was a voice very much in the political wilderness and few were those who supported him. The most prominent political figures in favour of devaluation were

[1] Germain-Martin (1936) p.276.

R.Patenôtre, who first favoured bimetallism and then devaluation,[2] he was also an assistant secretary of state in the Daladier government of 1933; H.Clerc, a radical deputy; the neo-socialist M.Déat; F.Delaisi advisor to the CGT; the socialist deputy Barthélemy Montagnon; G.Boris; and B.de Jouvenel.[3] Otherwise informed opinion was emphatically opposed to devaluation. Editorials in the two most prominent "bourgeois" dailies, viz., *Le Temps* and *Le Figaro* were vigorously opposed. The head of the C.N.P.F. (the employers federation) R.Duchemin opposed devaluation and presented a well articulated and cogent case against it. A.Gardey, *Rapporteur* of the Senate Finance Committee, was also opposed. One should note that Mouré (1991) states that Daladier's views on monetary policy were strictly orthodox.[4] However, by 1935 Daladier was toying with the idea of introducing a steadily depreciating currency, pejoratively dubbed "*monnaie fondante*," as advocated by S.Gessel and commended by Maynard Keynes.[5]

As we saw in chapter five, on financial orthodoxy, it was argued that devaluation would cause compensatory price rises and that any export gains would be temporary. In this regard opponents pointed out that UK exports only began to improve in 1933, whilst devaluation had occurred in 1931. It was also argued that UK prices had not risen to their previous gold values as commodity prices had fallen in the interim and that in any case sterling enjoyed the status of a vehicle currency and a substantial proportion of its imports were invoiced in its own currency (the most signal benefit enjoyed by a hegemonic currency). Giscard d'Estaing (*père*) who was recruited by the Bank of France to go on a speaking tour of French Chambers of Commerce to argue the case against devaluation would argue the point that the French franc did not enjoy the same privileges as sterling and that as a result of the law-of-one-price French prices would rise with the traded-goods sector leading the process.[6] Germain-Martin, several times Finance Minister during this period, would make the same point. The constant emphasis on foreign trade rather than the state of

[2] see Mouré (1991) p.100.

[3] see chapter five; and Mouré (1991) for biographical details.

[4] Mouré (1991) p.100.

[5] see Keynes (1981).

[6] see files at the Bank of France. Mouré (1991, p.206 footnote 66) cites Netter to substantiate the case that the Bank of France helped organise the anti-devaluation campaign.

internal trade is characteristic of the epoch.

Of particular concern to those more sophisticated commentators, such as Germain-Martin, who were not unwilling to consider devaluation was that it would be counter-productive until an international currency agreement could be secured. Without such an accord they feared that the US might still use its facility, under the Agricultural Adjustment Act, to further devalue the dollar. One should also recall that sterling was on a managed float and that since the 1933 World Economic Conference, if not the Ottawa conference, the UK had refused to enter in to any fixed exchange rate commitment (in this context one should recall that there were elections in 1935 and H.M.'s Government was not willing to agree to a fixed exchange rate commitment in such circumstances). One should recall that the French "collective" memory associated inflation and devaluation, following France's experience with currency and financial instability in the 1920s. It is also important to note that when the UK devalued all other countries were on gold, so there was little risk of retaliation bar trade related measures as introduced by France. But, when the devaluation issue was considered in France there was a very real prospect that other countries might allow their currencies to depreciate.[7]

Opposition did not come solely from the bourgeois parties, the communists were fiercely opposed to devaluation arguing that it would merely penalise the working class and erode the assets of small savers. Amongst prominent communists taking this stand were Doriot, Duclos and Thorez. The communists argued that the solution to the problem, which was essentially due to the fiscal crisis of the state, was to soak the rich. Herriot, radical-socialist party leader until 1935, was opposed to devaluation on similar grounds. His constituency was composed of rural small savers and the *petite bourgeoisie*. Blum, head of the SFIO, seems occasionally to have been ambivalent sounding more favourable to devaluation in 1934 and then backing-off arguing against both devaluation and deflation. He stressed, however, that the real crisis stemmed form the internal contradictions of capitalism, viz., the increased capacity of production and the skewed distribution of income, i.e., that the crisis was due to an incapacity to absorb (realise) the surplus without a fundamental shift in the distribution of income and wealth, which would mean a radical alteration in the control of the means of production. His thesis falls within a well documented underconsumptionist

[7] see Eichengreen Golden Fetters.

tradition of the left.[8]

L.Blum in articles in the socialist party's main organ, Le Populaire, argued on 29th and 30th September 1934, that devaluation was inevitable but needed to be accompanied by social measures and an *échelle mobile*, i.e., compensatory wage adjustments, in order to ensure that workers did not suffer. In an article on 20th September Blum had argued that devaluation would not prove inflationary as the inflation had already occurred, "*En France l'inflation n'est pas à faire, elle est déjà faite.*" In an article published on 19th September, in which Blum writes appreciatively of Roosevelt's policies he outlines his theory of the causes of the economic crisis. Namely that the root cause of the capitalist crisis lay in the contradiction between its increased productive potential and the capacity to consume (absorb) the surplus.[9]

In the same month Joseph Caillaux, former Finance Minister and all powerful Chairman of the Senate Finance Committee from 1932, expressed his opposition to devaluation. He rejected devaluation because of its effects on savings and the middle-class who are the "*armature*" (backbone) of society, and on the grounds that it would turn commerce into speculation.[10]

In an article in, *L'orientation économique et financière*, L.Boudin, Professor within the Law faculty of Dijon, argued in favour of remaining on gold.[11] In both France and Germany economics was taught in the Law faculties which from a Marxist and neo-liberal perspective would be considered perfectly appropriate highlighting as it does the essential importance of underlying property relations and rights to the mode of production and exchange. It seems likely that the fact that economics was taught in Law faculties contributed to the injection of a "moral" perspective on the question of devaluation which is so often apparent in the contemporary debate. And in particular the equation of devaluation with a breach of contract on which all exchange and freedom in a liberal society must rest, at least from the perspective of a 19th century liberal model. Galimand, who was a radical-

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[8] Bleaney (1976).

[9] Quoting Blum in Le Populaire, 19/9/34, "*Son explication profonde (la crise) réside dans la rupture d'équilibre que provoque nécessairement le régime capitaliste entre la production, ou, plus exactement, entre la capacité de rendement de l'appareil productif et la capacité générale de consommation ou d'achat.*"

[10] see Caillaux's article in *Agence Economique et Financière*, 5th September 1934.

[11] see *L'Orientation Economique et Financière*, 1/9/34, article by L.Boudin.

socialist, adduced a similar argument in the debate in the Chamber of Deputies on the devaluation bill on 1/10/36.[12]

In a series of articles in Le Figaro, Lucien Romier argued against devaluation. On 5th July we find him arguing that as prices had been maintained for electoral reasons (one supposes that he was alluding to wheat prices and other commodity prices, e.g., wine and sugar beet) devaluation would not annul these pressures and that therefore these forces would still be present and, as a result, prices would rise. Furthermore, devaluation would badly erode the credit of the state and savings. His view was that the solution to the crisis lay in a rise in prices which would follow the lead of anglo-saxon currencies as the universal credit mechanism revived.

In a following article published on 9th July we find Romier critically examining the UK's stabilisation record, which those in favour of devaluation used as an illustrative case. Here he argued that the recovery in the UK was due to cheap money and Imperial Preference. We would concur, however it is precisely because the UK abandoned its fixed exchange rate commitment, viz., the gold standard, and established an exchange equalisation account and a balanced budget, that it was able to adopt an expansionary credit policy. This argument does not therefore vitiate the cause of devaluation in France.

In an allusion to the uncertain international environment in which any devaluation might take place and the primacy which the US set upon domestic considerations, particularly evident following the US government's silver purchases, Romier argued that the value of the dollar was solely determined by considerations of domestic political expediency.[13] And he argued that gold remained the only acceptable (ultimate) means of international settlements, in particular in case of war.[14] Should there be a need for monetary reform the crucial question, according to Romier, must be the rate at which the anglo-saxons stabilised their currencies.[15]

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[12] see chapter nine of this thesis.

[13] "*L'avenir du dollar ne dépend pas plus aujourd'hui qu'hier de l'application d'une doctrine proprement monétaire. Il dépend des exigences d'un régime électoral.*" From L.Romier in, Le Figaro, 9/7/34.

[14] "*...l'or est la seule monnaie qui permette de se ravitailler au dehors et de se défendre en cas de guerre.*" (see article pub. by Romier, 11/8/34, in Le Figaro). If that is the case, surely it would be best to suspend the gold standard in order to preserve strategic gold reserves?

[15] see article by Romier in, Le Figaro, 17/8/34.

Romier suggested, contrary to some of the arguments adduced by those in favour of devaluation, that it would not assist exports as they were affected by quotas and other barriers (cf., 13/8/34), though an end to exchange dumping could well lead to disarmament on the trade front (q.v., the Tripartite Agreement). In tacit sympathy with the communists' opposition to devaluation he argued that it would erode real wages and penalise the working class (15/8/34). After a devaluation nobody would be willing to hold public debt and the deficit would have to be covered through increased taxes (though of course public debt only represents a capitalised stream of future tax liabilities foisted involuntarily on future generations), or, inflation. Romier reckoned that both would probably be resorted to and that this would cause a hoarding of savings and a flight of capital.[16] Furthermore, devaluation would not help farmers (see also Herriot) as costs were mainly accounted for by capital goods whose prices were not likely to fall and labour costs would rise faster than agricultural commodities. However, given the artificially high agricultural prices which France maintained by means of protection and wheat boards a devaluation would lessen the necessary implicit subsidy, or "producer subsidy equivalent", and benefit consumers. Finally, Romier argued[17] that interest rates needed to be lowered and that this would be easy once the budget was balanced.[18] He also emphasised the need to remove all forms of protection which maintained prices. Here at least he agreed with the logic of Reynaud's argument, cf., his speech on 28 June 1934 on *projet de loi.*

In Le Temps Frédéric Jenny rehearsed many of Lucien Romier's arguments. Jenny argued that one of the problems associated with devaluation were the large quantities of notes hoarded in France, amounting to some 25-30 bn. (*milliards*) French francs, which he suggested would flow into real values and cause prices to rise. Protection could be expected to follow devaluation if real prices fell. This is probably an allusion to agricultural subsidies which might be lifted in case of devaluation. Jenny emphasised the need to stabilise exchange rates and respect contracts and that in such circumstances one could expect

[16] see article by Romier of 16/8/34 in, Le Figaro.

[17] see article of 15/9/34.

[18] However, as we have seen attempts at deflation proved counter-productive and led to widening budget deficits. The falling price level meant that real interest rates actually rose, invalidating the "crowding-out" thesis.

recovery.[19] Devaluation would only have a momentary beneficial effect on the government deficit, after a while the floating debt would not be renewed and the treasury position would deteriorate. Devaluation would hurt workers, whilst only speculators and troubled debtors would benefit. Jenny also argued that another devaluation (following the Poincaré "stabilisation") would bring final ruin to the middle-class and erode the social fabric.[20]

Just as Romier had dismissed comparisons between sterling devaluation and the existing circumstances of the franc, Jenny argued that the Czecho-Slovak devaluation, of 1934, did not lead to any real improvement and that its increased exports were due to German imports which were unrelated (one should recall that German trade policy at the time was perhaps closer to Comecon bloc trading relations that anything based on free markets), and to weapons exports. Jenny pointed out that the Czecho-Slovak devaluation was followed by extensive controls which gave the measures the very minor success which they achieved.[21] Jenny stated that he thoroughly approved the paper presented by P.Reynaud at a conference in Belgrade in which he argued in favour of maintaining the gold standard.[22] Reynaud's paper attributed the depression to falling commodity prices due to an over-extension of credit and to the ensuing fall in demand for manufactured goods. Reynaud went-on to argue in favour of the gold standard, though no mention, as I can recall, was made of gold parities.[23]

However, in the speech which Reynaud had delivered a few months earlier, on 28/6/34, during the discussion of the *Projet de loi* on fiscal reform it was clear that Reynaud's preference lay in a well prepared devaluation. This speech appears to have sparked the debate on devaluation in earnest. In it Reynaud alluded to the contradiction between exchange controls and internal protection (which had resulted in far higher domestic

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[19] see article in, Le Temps, 13/8/34.

[20] Quoting F.Jenny in, Le Temps (13/8/34), "*Les classes moyennes, déjà si atteintes par la chute du franc autrefois, se verraient définitivement ruinées et menacées d'élimination pure et simple. Il n'est pas besoin de dire quel ébranlement profond subirait alors l'ordre social établi.*"

[21] see article in Le Temps 22/4/35.

[22] cf., Jenny, 24/9/34.

[23] Copy of speech in the archives of the Bank of France.

wheat prices) and the liberal commitment to the gold standard.[24]

Reynaud went-on to point out that a strong government would be needed to pursue deflation and alluded to Mussolini's policies. In Reynaud's view, current policies would lead to a forced devaluation (*à chaud*) with all the inconveniences of such an operation, as opposed to one prepared well in advance (*à froid*) and concluded that it was up to the government to make its choice.[25]

Mouré (1991) argues that not enough of a distinction has been made between the period up to 1934 when Reynaud advocated deflation and thereafter when he made explicit the options that lay before government, without explicitly coming out in favour of devaluation.[26] However, one must ask whether or not he was displaying judicious restraint so as not to unsettle the foreign exchange markets, certainly the Bank was concerned that he should remain circumspect in the matter. Mouré also points out that Reynaud, unlike Boris and Patenôtre, wanted devaluation accompanied by a balanced budget and did not favour a floating exchange rate, but stabilisation at a lower gold par.[27]

Germain-Martin in, "*extraits de l'exposé des motifs de Budget Général de l'exercice 1935*," underlined the psychological impact of devaluation, as it had come to be associated with inflation, following the experience of the 1920s.

In a speech entitled, "*La France devant les expériences de dévaluation monétaire*," delivered at Le Havre, J.Barthélemy (*membre de l'Institut*), argued that inflationary finance would only temporarily cover a deficit, without however providing any long term solution, whilst foisting the problem on the next government. Barthélemy argued that only the government temporarily in power will have benefited. Tomorrow there would be another government in its place and it would in turn have to find an expedient. Barthélemy argued that this was the price one had to pay for France's democratic regime. There was no

[24] Quoting Reynaud, "*Comme ses prédécesseurs, le Gouvernement est orthodoxe et libéral en matière monétaire, car là, monsieur le ministre des finances, vous n'allez pas protester. Mais il est antiorthodoxe et antilibérale en matière économique.*" in, B.F., 4/N 383, p.8.

[25] Quoting Reynaud, "*A mon avis, la politique suivie depuis deux ans conduirait à une dévaluation monétaire non pas voulue, mais imposée, à une opération qui ne serait pas faite à froid, mais à chaud.*

"*Au point de vue technique, aujourd'hui, le Gouvernement à la liberté entière de son choix...*" Reynaud's speech reported in Journal Officiel, Chambre des Députés, 28/6/34, p.9.

[26] Mouré (1991) p.202.

[27] op.cit., p.204.

stability,- no representation of the collective interest.

Barthélemy argued that without a reform of the state there could be no political reform and without political reform no financial reform.[28] He argued forcefully that the political regime, as it existed, only reflected groupings of particular interests and that the system was openly abused by self-seekers and vested interests trying to placate their respective lobbies. This is an argument that we have tried to develop in chapter one and is consonant with the views of A.Tardieu.

Barthélemy wanted to get rid of protection which maintained prices artificially high, and of the *patente* (a trading licence) which stultified enterprise. He argued in favour of a renewal of public spirit. The conference which he was addressing was organised by the *Service des études*, of the Bank of France, of which Lacour-Gayet was head.

In a speech before the *Société pour la défense du commerce et de l'industrie de Marseille*, Giscard d'Estaing (*ancien inspecteur des Finances*) alluded to the special case of sterling and rejected the theory that prices were established in gold. Giscard argued that prices were determined by the vehicle currency in which trade was invoiced and, implicitly, given the law-of-one-price devaluation would lead to compensatory price rises. Therefore, comparisons with sterling were inappropriate.[29] This speech was one of a series delivered at the behest of the Bank of France to counter the devaluation campaign. Giscard was vigorously opposed to devaluation for all the reasons adduced by the other anti-devaluationists reviewed here.

Many of the anti-devaluationists pointed-out that France's share of world exports had fallen less than that of countries that had devalued.

In an article published in Le Temps (9/9/34) Duchemin, head of the French

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[28] Quoting J.Barthélemy, "*Qui aura profité de la situation? Les gens qui se seront trouvés, à un moment donné, à la tête de l'Etat. Demain, il y en aura d'autres. Ils se débrouilleront. C'est le péril de notre régime démocratique, où il n'y a pas de stabilité, où il n'y a pas de représentation permanente de l'intérêt général.*" (p.13). He quotes the, "*baron Louis: "Faites-moi de bonne politique et je vous ferai de bonnes finances.*"

"*Sans réforme de l'Etat, il n'y a pas de réforme politique; sans réforme politique, il n'y a pas de réforme financière. Il est impossible d'en sortir avec un régime électoral qui n'est que l'organisation des appétits particuliers, qui soumet le budget aux parties prennantes et aux ordres mendiants, à ces ordres mendiants qui mendient aux portes du Trésor.*"(pp. 33-34). From Barthélemy, "*La France devant les expériences de dévaluation monétaire,*" in, *Banque de France, liasse 7*, 4/383.

[29] Quoting Giscard d'Estaing's speech before the "*société pour la défense du commerce et de l'industrie de Marseille*, "*Les prix mondiaux résultent de la monnaie dans laquelle les contrats sont normalement faits pour une catégorie donnée de marchandises.*" p.10.

employers' organisation, voiced his opposition to devaluation and expressed the fear that sterling and the dollar might engage in a retaliatory devaluation.

J.Caillaux, in La République (9/9/34), argued along the same lines as Duchemin, and averred that one could not compare the UK's devaluation with a prospective French devaluation as sterling's devaluation of 1931 was equivalent to the devaluation of the franc in 1926-28 and marked a re-adjustment to the UK's impoverished post-war state. Furthermore, Caillaux argued that devaluation would destroy the "*esprit d'épargne*" and affect the mentality of the middle classes, the bulwark of the country. Caillaux associated devaluation with inflation.

Jacques de Neuflize, private banker, Regent of the Bank of France and archetypical member of the so-called "*deux cents familles,*" aired his opposition to devaluation before the Paris Chamber of Commerce. He rejected a deliberate act of devaluation which would after but a short respite confront policy-makers with the same difficulties made worse by devaluation. He had a point,- as experience would prove. As Reynaud argued in the parliamentary debate on the devaluation bill (28/9-1/10/36), devaluation did not constitute a policy in itself. De Neuflize suggested that rather than lower domestic prices, devaluation might well lead to a rise in nominal and real prices. Deflation was therefore the only course. The priorities should be, reduction of government expenditure; lower interest rates; lower costs of living and amortisation of the public debt.[30]

Germain-Martin keenly identified the contradictory statements made in favour of devaluation by its advocates who in turn argued that it would stimulate exports, whilst others averred that it would raise prices which should stimulate economic activity.[31]

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[30] Quoting de Neuflize, "*Il est triste seulement de voir encore admettre comme possible le renouvellement d'une mesure douloureuse que nous avons pu supporter naguère, parce qu'elle consacrait un état de fait, mais qui cette fois, constituerait un appauvrissement voulu et nous laisserait, après une courte période d'activité trompeuse, devant les mêmes difficultés, accrues de tout ce que nous aurions sacrifié.*

"*Car il n'est nullement prouvé que la dévaluation du franc sera sans effet sur les prix nationaux et que, loin de les faire baisser, elle ne les fera pas monter.*

"*C'est donc à la déflation des prix, en dehors de toute manipulation monétaire, qu'il convient de s'attacher.*" And he adds, "*Trois buts sont à poursuivre: compression des dépenses budgétaires, abaissement du taux de l'intérêt, réduction du coût de la vie. Et on devrait pouvoir ajouter: amortissement de la dette publique.*" De Neuflize, see B.F., archives 4/N 384 B, 11/12/34, p.7.

[31] Quoting Germain-Martin (1936), "*A notre opinion, hier et plus encore aujourd'hui, la dévaluation ne peut par elle-même ranimer l'économie. Il est facile de souligner la contradiction des dévaluateurs quand ils affirment d'une part que la dévaluation assurera une prime aux exportateurs, ce que ne peut exister que si les prix intérieurs ne haussent pas, et d'autre part qu'il y aura hausse des prix nationaux, qui doit faire repartir l'économie.*" p.369.

Germain-Martin in his book (1936), which covers his term at the Ministry of Finance (4/2/34 to 31/5/35) during which the devaluation debate largely took place, argued that devaluation was rejected in 1934 because of the need to maintain public credit so as to be able to borrow in order to finance the state deficit. Any devaluation would have been followed by rising prices, a drop in savings, a fall in purchasing power, and social discontent. Furthermore, discrete consultations with the US and UK had failed to secure any exchange rate commitments.[32]

In his book, Germain-Martin (1936), also condemned those brilliant, but less than judicious, minds who had undermined the franc by arguing that budget balance was not necessary. This may well be a swipe at Reynaud, although Reynaud did advocate a package comprising devaluation and fiscal measures.[33] Though, it may be that Germain-Martin's allusion was more properly addressed to G.Boris (*vide infra*).

Germain-Martin argued that government had had to think about its debt management policy. Government had to protect savings and devaluation amounted to bankruptcy. One did not go bankrupt voluntarily! Devaluation would ruin the state's credit and impair savings. Price increases would reduce purchasing power and cause social disturbances. He added that the government was unanimously against devaluation, not least because informal inquiries at both the UK and US treasuries had not met with any commitment to stabilise currencies.

Mouré doubts whether Germain-Martin had been working toward devaluation whilst in office.[34] However, my own reading of the archives suggests that the policy-making establishment had come round to this view in early 1935 and certainly after the Belgian

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[32] Quoting Germain-Martin (1936), "*Il fallait aussi penser aux lourdes opérations de trésorerie. Notre devoir était de défendre le patrimoine des épargnants. La dévaluation est une faillite. On ne fait faillite que s'il n'y a plus d'espérance d'amélioration. Ce n'était pas le cas en 1934. Nous le verrons. Toute manipulation monétaire en France eut donc amené inévitablement la ruine du crédit de l'Etat et de l'épargne nationale, la hausse des prix intérieurs, une réduction générale du pouvoir d'achat, des perturbations sociales. Le Gouvernement tout entier rejettait toute idée de dévaluation comme contraire aux intérêts véritables du pays, et d'autant plus que les démarches discrètes faites auprès des trésoreries anglaises et américaines ne donnaient aucun apaisement quant aux éventualités possibles et prochaines d'une nouvelle amputation de ces deux grandes monnaies.*" p.276.

[33] Quoting Germain-Martin (1936), "*Or, au moment où la confiance du public devait être plus que jamais soutenue et fortifiée, des esprits plus brilliants que justes se mirent à déclarer que l'équilibre budgétaire était une mystique, que l'égalité des recettes et des dépenses ne représentait point la fin indispensable de toute opération financière; ce n'était pas un but qu'il était nécessaire d'atteindre.*" p.257.

[34] Mouré (1991) p.240, footnote 11.

devaluation of that year. Though it was understood that this could not be a unilateral act, both to save face and sell the policy domestically, but also to avoid any retaliatory devaluations.

Amongst those in favour of devaluation R.Patenôtre (a former *sous-secrétaire d'Etat*) in, Le Petit Journal,[35] contradicted Duboin and argued that the franc would not in a sense be devalued because since 1928 its real purchasing power had increased (cf., 8/9/34) and gold prices had fallen since the 1926 stabilisation. Patenôtre, who owned and edited the Petit Journal[36] argued that deflation caused deficits and higher interest rates.[37] In November 1935 Patenôtre (a deputy) called for devaluation as prices had fallen to such an extent and the real debt burden risen that one could not continue to deflate.[38]

One should note that both Patenôtre and Boris thought that a shortage of gold was partly to blame for the depression, hence Patenôtre's earlier advocacy of bimetallism. Amongst those blaming a gold shortage was H.Clerc, who argued that reserves be redistributed.[39] Mouré alludes to Boris' support for the US devaluation and his attack on the balanced budget "*mystique*."[40] Boris argued that it was ridiculous to reduce expenditure in a crisis caused by a drop in purchasing power. Mouré points out that Boris, "had called for devaluation since 1932."[41]

Marcel Régnier, Senator and "*rapporteur Général du Budget*," as well as future Finance Minister in the Laval government, expressed his opposition to devaluation in L'Information (11/9/34), on the grounds that it would be a repudiation of a large proportion of debt and that it would it make it that much harder to renew. In, Le Moniteur intérêts et matériels, (12/9/34) we also find Senator Dumont voicing his opposition to devaluation. Amongst other opponents of devaluation one finds Professor Gaston Jèze, of the Law Faculty

[35] *Le Petit Journal*, 8/9/34.

[36] see Mouré (1991).

[37] see press cuttings from La Flèche in Bank of France "*service des études* II," 4/N 383.

[38] see Bank of France, *service des études* II, 4/N 383, devaluation campaign 1934-36.

[39] see Mouré (1991).

[40] Mouré (1991) p.193.

[41] Mouré (1991) p.194.

of the University of Paris (Jèze had been on the Sergent committee and had voiced his opposition to it, particularly the emphasis on increased indirect fiscal revenue - Jèze, was an economic advisor to the radicals). E.Allix, Dean of the Law Faculty (*Doyen de la Faculté de Droit*) also opposed devaluation using the familiar arguments and on the assumption that if one devalued once it was an experience that was likely to be repeated - in the event he was right!

Daladier, former Prime Minister and head of the radical-socialist party from 1935, was very much criticised at the Radical congress for his suggested plan for implementing public works financed by bank notes to the value of 20bn. (*milliards*) French francs which would lose 5% of their value every year. This idea had been the brain-child of Silvio Gessel.[42] This had been put into practice in the small Austrian town of Woergl in 1932. It aimed at stimulating money demand by taxing real balances, kicking the economy out of a liquidity trap, increasing the velocity of circulation and the demand for goods, thereby stimulating economic activity. The scheme was dubbed, by its detractors, "*la monnaie fondante.*"

As we have pointed out opposition to devaluation was not only to be found to the right of the political spectrum, but also amongst communists who argued that devaluation would erode real wages and that the real answer to the crisis was to raise taxes on the rich. This, in a sense, demonstrates that some communists were still looking at the crisis from a purely financial and fiscal perspective (that is while analyzing capitalism from within its own parameters). Jacques Duclos writing in the communist mouth-piece, L'Humanité, argued that, devaluation reduced the real purchasing power of all those on fixed incomes, viz., salaried workers, *rentiers*, shop-keepers and peasants.[43] Duclos suggested a tax on the rich as a solution to save the franc.[44] For Duclos devaluation would only hurt small savers, and

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[42] see Keynes's General Theory. Keynes had looked at it with some favour. However, it seems to us that simply increasing the money supply is a cheaper and less administratively cumbersome way of stimulating the velocity of circulation.

[43] Quoting Duclos, "*La dévaluation en diminuant la valeur du franc, frappe tous ceux qui ont des revenus fixes, elle diminue les revenus réels des salariés, des rentiers, des petits commerçants et des paysans.*

"C'est une folie de prétendre que la dévaluation peut ramener la prospérité. Elle ne pourrait que précipiter notre pays dans une misère plus grande."

[44] Quoting Duclos, "*Soucieux que nous sommes de protéger la petite épargne que la dévaluation ruinerait, nous voulons que les riches paient.*" (*L'Humanité* 5/11/35).

reduce the real income of wage earners, small shop-keepers, *rentiers* and peasants. Duclos argued that it was folly to believe that devaluation could bring back prosperity, it would only exacerbate existing distress.

Maurice Thorez, the leader of the communist party, speaking in the Chamber of Deputies on 29/11/35,[45] rejected devaluation. Thorez argued that the crisis was not monetary. The monetary crisis was, but, an outward manifestation of the more deep-rooted problem which lay in the internal contradiction of capitalism, viz., its increased productive potential and the inability to absorb the surplus given the existing distribution of wealth.[46] Thorez argued, as did Blum, that workers suffered both during deflation and as a result of devaluation and the solution lay in, "soaking the rich."[47] The first measure which he recommended pending the introduction of a wealth tax (*impôt sur les grosses fortunes*) was a tax on high incomes. The revenue would be used to fund public works and to stimulate economic activity. He also wanted to abolish the *Conseil de Régence* of the Bank of France. This latter objective was shared with the socialists and the radical-socialists (see Daladier's diatribe against the, "*200 familles*").

As we will see Blum's views were close to Thorez's. In an extract from a speech delivered by Blum in the Chamber of Deputies on 29/11/35,[48] Blum argued that deflation and devaluation both hurt the working class, the former by causing unemployment and the latter by reducing real wages.[49] Blum argued that devaluation on its own was not sufficient

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[45] Quoting Thorez, "*Pour notre part* (that is the communists), *nous restons fermement opposés à une nouvelle amputation du franc. Nous considérons que la dévaluation apportera un surcroît de misères à la masse des travailleurs.*

"En effet, elle signifierait une diminution des salaires réels, des traitements et pensions, des coupons des petits rentiers et cela au seul profit des capitalistes." Reported in La Flèche, 29/11/35. Other references are from articles published in La Flèche. These press cuttings are to be found at the Bank of France under "*service des études*," 4/N 383.

[46] Quoting Thorez, "*La cause des crises réside dans la contradiction croissante entre les immenses possibilités de production et la capacité de consommation toujours plus limité des masses.*" Reported in La Flèche, 29/11/35.

[47] Quoting Thorez, "*faire payer les riches.*"

[48] reported in La Flèche 4/4/36.

[49] Quoting Blum, "*Et c'est assez montrer que ce serait faire peser sur notre classe ouvrière une calamité effroyable que d'envisager seulement la dévaluation monétaire sans une véritable révolution industrielle et économique à laquelle j'espère bien que les défenseurs de la dévaluation dans cette assemblée sont d'avance résolus.*" Reported in La Flèche on 4/4/36.

it needed to be accompanied by an industrial and economic revolution.

Blum wanted neither deflation nor devaluation, *"Ni déflation, ni dévaluation"*,[50] words which would eventually come to haunt him. Blum wanted to increase consumer purchasing power and introduce a 40hr. week (with the same wages) and public works. He also supported raising agricultural prices through *offices publics*, i.e., public wheat purchasing agencies. This was a continuation of the policy initiated by Flandin. Blum advocated the nationalisation of credit, in part to lower industrial prices. Blum also favoured reducing the fiscal burden in order to reduce the disparity between costs and sale prices (presumably indirect taxes).

Blum's policy prescriptions were consumption-led. Increased demand should stimulate production which in turn would stimulate the renewal of capital stock. Increased output, given high fixed costs and low marginal costs, would make it easier to spread costs (per unit of output) and finance re-tooling without stimulating a price spiral.[51] In practice, of course, the Popular Front government would see spiralling wages and falling output. Any incipient recovery which might have followed devaluation, killed in the bud by supply-side rigidities, e.g., the 40hr. week, and steep increase in wages.[52] In Le Populaire Blum reiterated his commitment to a consumer led recovery.[53]

Bertrand Nogaro, a well known inter-war economist and author came out in favour of devaluation in a paper for Annales de l'Université de Paris.[54] Nogaro alluded to the paradox, which Reynaud would stress, that the *surtaxe de change* (the compensatory duty introduced when the UK devalued) prevented French prices from adjusting and kept them artificially high.[55] He defended devaluation on the grounds that countries which had devalued had not seen prices rise as much as the exchange rate had depreciated. This was

[50] For a development of this thesis see "*discussion générale du Budget 1933.*"

[51] Quoting Blum, "*...stimulation de la production par la stimulation de la demande, rénovation économique par l'accroissement de débit de l'appareil productif et par la répartition, sur un plus grand nombre d'unités produits des frais incompressibles de l'industrie.*" source, *ibid.*

[52] see Marjolin (1938); and Eichengreen Golden Fetters, p.384.

[53] Quoting Blum, "*Le programme socialiste, c'est le développement de la capacité générale d'achat, l'accroissement de la masse des revenus consommables, la stimulation des échanges.*" (Le Populaire, 10/9/35).

[54] Sept./Oct. 1935, in, Bank of France 4/N 383 *études* II.

[55] op.cit., pp.421-422.

particularly the case in the UK, i.e., they had enjoyed a real exchange rate depreciation. Nogaro recognised the special circumstances of other devaluations (which Giscard d'Estaing and Germain-Martin had particularly stressed), but he argued that although prices would rise in France they would not rise *pari passu* with the rate of devaluation.[56] Nogaro suggested reducing tariffs along with devaluation to avoid price rises. Though this would affect budget revenue, it would be more than compensated by increased revenue as economic activity picked-up. In case of retaliation he suggested that the franc be allowed to follow any generalised devaluation.[57]

The Bank of France's analysis of Nogaro's argument, was that even if devaluation were decided the question of the exchange rate would still remain as sterling was floating.[58]

One of the more cogent and well articulated arguments in favour of devaluation was made by François Delaisi, advisor to the C.G.T.[59] He argued that devaluation would prompt a return flow of capital, allowing debt to be refunded at a lower rate of interest. Part of the profits realised on the operation would be used to set up an exchange equalisation account, another to reimburse borrowings by the Treasury from the Bank of France and the balance would be held by the Bank of France on Treasury account. Delaisi thought that devaluation was inevitable in order to improve the economic situation and that public works would be needed to reduce unemployment. Lower interest rates, as a result of devaluation, would make it easier to borrow to fund public works.

Delaisi pointed out that the remaining Gold Bloc currencies, viz., Holland, Switzerland and France were overvalued and that a realignment of currencies was needed to jerk international exchange into life again. However, an accord with New York and London would be needed to avoid competitive devaluations. This was also the view of the C.G.T. Delaisi denied, as some purported, that devaluation would lead to price rises as the post-war

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[56] One should note by contrast that for most US and UK economists the attraction of devaluation lay in that it would raise prices.

[57] Quoting Nogaro, "*Enfin, il parait ressortir de ce qui précède que la riposte la plus adéquate, techniquement, à une dévaluation généralisée des monnaies étrangères est dans une dévaluation semblable.*" (p.422, op. cit.).

[58] "*Permettez-moi seulement d'observer que, si une dévaluation du franc était décidée, la fixation du taux de cette dévaluation serait très malaisée du fait de l'instabilité de la livre sterling.*" (cf., B.F., *services des études* I, 4/N 383, this statement appears to be either the view of the Governor or that of his cabinet).

[59] see article in La Flèche, Bank of France 4/N 383 *service des études*.

situation was quite different and that at the present time there was not a problem of scarcity but rather a state of depression prevailed. He also pointed out that devaluation in other countries had not been followed by price rises. Though he failed to recognise the point made by Giscard d'Estaing and others that sterling, in particular, was a vehicle currency. Delaisi also wanted controls imposed on Trusts, banks and the Bank of France. Most of his policy suggestions were in fact implemented by the 1936-37 Blum government, but unfortunately not as part of an explicit and deliberate policy and the attempt to tax speculative profits did nothing to restore confidence and precipitate a return capital flow. It appears the Delaisi was the monetary technician of the Popular Front, - he proposed a 40% devaluation of the franc.[60]

Amongst other commentators sympathetic towards the devaluation issue we find B. de Jouvenel. He attributed the significant fall in wholesale prices to the disparate nature of production and the lesser fall in prices for goods in the industrial sector to its more concentrated nature, which resulted in quantity adjustments, viz., unemployment (i.e., the latter sector is characterised by fix prices - cf., Hicks - and adjustments are made in volume terms whilst the former is a flex price world in which prices bear the strain of adjustment). De Jouvenel pointed out that falling prices had increased producers' real debt burden. He was critical of the radicals' deflationary policies.[61] De Jouvenel argued that French economists destroyed their case in favour of devaluation by claiming that it would lead to an increase in exports, as opponents of devaluation pointed out that in practice this had not happened as commerce was affected by quotas more than anything else, thus vitiating the premise on which the argument for devaluation was based. De Jouvenel argued that devaluation should be defended on the grounds that it would raise domestic prices and so stimulate domestic activity.[62] Eichengreen notes that de Jouvenel, "suggested at the beginning of 1933 that the franc and the dollar be devalued simultaneously."[63] And he adds that, "the Socialist Deputy Barthélemy Montagnon advocated reflation and devaluation along

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[60] see article in, Les Nouvelles Economiques et Financières, 26/5/36, B.F., E69, *Politique monétaire, Presse*, 1936.

[61] see Mouré (1991) p.43.

[62] source: *La Flèche*, Bank of France 4/N 383 *service des études* II.

[63] Golden Fetters, p.355.

British lines." Mouré (1991) indicates that Barthélemy Montagnon attacked deflation as inequitable and inoperable as long as protection kept agricultural prices up, a paradox to which Reynaud would allude. H.Clerc also attacked the passivity before the crisis.[64] These references are to 1933. Mouré suggests that Clerc came out in favour of devaluation, as opposed to deflation, in 1935,[65] whilst Barthélemy Montagnon was more emphatic in his preferences for devaluation.

Amongst officials who favoured devaluation one should mention E.Monick (Financial Attaché, Washington 1930-34; London 1934-40) who, "became convinced in 1934 that France had to devalue and need not fear catastrophic results."[66] Apparently in September 1935 Monick advocated a slight devaluation of the franc, as a complement to deflation, on the grounds that there was little prospect of retaliation as this would only worsen relations between the anglo-saxon nations and Mouré adds that, "The concern for reprisals was an excuse for inaction."[67]

One should also mention P.Quesnay who proposed, ahead of the London World Economic Conference, that gold reserves be pooled at the BIS and used as guarantee against currency reserves of central banks.[68] Quesnay was then General Manager of the BIS.[69] His policy prescription tends to validate the British maldistribution of gold thesis. However, it was rejected.

In La Flèche we also find R.Lacoste arguing that devaluation was inevitable as deflation had failed. However, he argued that in order to avoid passing the costs on to workers revolutionary economic changes were needed, viz., planning. Planning as a "rational" solution to the economic crisis was to increasingly find favour amongst younger technocrats during the 1930s.[70] H. de Man, Minister of *Travaux Public* in Belgium who

[64] see Mouré (1991) p.100.

[65] see Mouré (1991) p.199, footnote 33.

[66] see Mouré (1991) p.230 & pp.234-235.

[67] see Mouré (1991) p.235.

[68] see Mouré (1991) p.101.

[69] Further biographical details of *dramatis personae* in Mouré (1991) pp.281-283.

[70] see Jackson (1985).

was to influence *Planisme* in France, supported the policy of devaluation in Belgium.[71] J.Duboin argued that money was but an epiphenomenon of the crisis and that a reform of the economic system was needed along with policies to stimulate demand,- though his contribution is rather vague on policy prescription. In an article in L'Oeuvre (19/7/35) Duboin argued that the crisis was due to overproduction and that there was an incompatibility between production and consumer purchasing power, and that a new social order and economic framework was needed.[72] Duboin argued that at least Laval was deflating prices too, whilst Germain-Martin had pursued a policy solely of wage deflation. This is a good point, at least Laval's policies were, on the face of it, more equitable and logically consistent.

After the Belgian devaluation Germain-Martin pointed out that Belgium had not devalued because of a lack of gold, but because domestic banks faced a crisis,[73] the inference to be drawn being that as the French banking sector was not suffering similar conditions a devaluation would be inappropriate. Eichengreen alludes to the policy dilemma confronting the authorities under such circumstances, only suspension of the gold standard could allow the authorities the freedom of manoeuvre in such a case.[74] Germain-Martin emphasised that UK prices had not risen following devaluation because many goods were invoiced in sterling and devaluation had occurred during a period of downtrend in the world price level. He argued that if the franc were devalued, and we must assume that he expected this to be accompanied by a freeing of agricultural protection, agricultural prices would have to fall causing a crisis. He also wondered where the purchasing power would come from to buy goods if retail and industrial prices rose. Germain-Martin argued that devaluation would amount to an expropriation of millions of small savers (*petits-épargnants*)[75] and wondered how the substantial loans to finance the deficit on account of military expenditure and large railway deficits would be raised. However, he admitted that anything would be better than

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[71] see La Flèche, ibid..

[72] source: B.F., 7/E 69.

[73] see also Griffiths (1987).

[74] Golden Fetters, p.361.

[75] Though the real revenue of those receiving fixed coupon payments and other fixed nominal contractual payments had risen sharply during the depression due to the fall in prices.

the present hesitant and uncertain situation which was preventing any change or improvement as entrepreneurs waited. These arguments are reiterated in Le Capital (7/11/35), where he underlined that devaluation would be inflationary.

Regarding the Belgian devaluation Patenôtre took a different view arguing that the Belgian experience had raised the price level (a policy which the Belgian government actively encouraged, cf., Griffiths), this had stimulated activity and increased fiscal revenues.[76] Patenôtre also pointed out that far from impoverishing various groups the price level in Belgium remained 20% below its 1930 level and the *rentes* (consols) had improved. Patenôtre went on to argue that a 50% devaluation would be appropriate as world prices had fallen 50%, i.e., gold prices were too low, or the value of gold too high. This was very much the view expressed in the Gold Delegation report and by Hawtrey and I.Fisher. Patenôtre reiterated this argument in *Le Petit Journal* (14/11/35) arguing that the Franc Poincaré had appreciated and a devaluation was needed to restore its previous purchasing power.

The *Petit Journal* (8/11/35) called for devaluation as deflation of the order of 50% would be needed and this would raise real debt burdens by 100% which would cause an economic crisis, this argument is in full accordance with I.Fisher's "debt deflation" theory of the depression.

Henri Clerc, radical deputy for the Haute-Savoie, declared that he thought Reynaud 80% right on the need for devaluation, but that one could not resort to it as such a successful campaign had been waged against it. And that if one devalued there would be a consequent flight into real values and the policy would fail. Therefore, Laval should resort to a policy of credit expansion, "*à la Hoover*," with an overvalued exchange rate and trust his luck.[77]

Emile Roche in *La République* (25/11/35) opposed Patenôtre's call for devaluation, preferring deflation and pointed out that the UK's success was dependent on the international role of sterling. What was needed was a balanced budget which would lower interest rates, this would stimulate a rise in the *rentes* (gilts) which should make a debt conversion

[76] see his article in *Le Petit Journal* 12/9/35.

[77] see Clerc's article in *L'Oeuvre*, 11/11/35.

operation easier and reduce the debt.[78]

In an article in Le Petit Journal (19/11/35) we find a reply to Emile Roche's arguments. The article takes up Patenôtre's argument that, far from spoliation, prices in Belgium since devaluation had not risen to their 1930 level and were still some 20% below. Devaluation therefore, though not a programme in itself, would constitute a return to an economic equilibrium and a base on which one could build. The Petit Journal saw devaluation as a means of restoring equilibrium between wholesale and retail prices and the real debt burden (cf., 1/11/35).

E.Herriot in an article in, L'Ere Nouvelle, (10/4/36) expressed similar views to Germain-Martin (who had been his Finance Minister in 1932) arguing that one could not compare devaluations in the UK and US as goods imported into those countries were invoiced in their own currencies. And that a devaluation would alter relative prices between the agricultural and industrial sectors, to the advantage of the latter (Trotsky's scissors in reverse, due to the existing support for agriculture through protection and subsidy which would be removed in case of devaluation) and that the UK might retaliate. This could lead to further protection as well as domestic inflation. Herriot defended agricultural protection as a means of maintaining purchasing power. Any export premium derived from devaluation would be short-lived due to price rises and devaluation would also reduce internal absorption (*débouchés*) presumably due to the fall in income of the agricultural sector. Herriot also argued that activity had begun to pick up in 1935. After the trauma of the first *Cartel* government, Herriot was to stick to soundly orthodox policies as premier in 1932.

In L'Ere Nouvelle (26/11/35) we find Léo-Abel Gaboriaud inveighing against devaluation arguing that it would expropriate, "*tous les possédants*," *rentiers*, pensioners. The idea of a gold embargo to stem the gold outflow is dismissed by M.-G.Mitzakis, editor of L'Intransigeant (26/11/35) in which he argued that this was tantamount to a devaluation

[78] It is interesting to note that E.Roche and Germain-Martin's policy prescriptions are close to those adopted by the British Chancellor of the Exchequer, G.Howe, in 1981. To the vocal opposition of most the British economic "establishment." The fiscal squeeze proved a resounding success, the sharp appreciation of the exchange rate allowed interest rates to fall rapidly and paved the way for economic recovery, confounding the 364 economists who had condemned his policies in an open letter to the Times. The crucial difference here is that Germain-Martin, *et.al.*, advocated these orthodox policies within the constraints of a fixed exchange rate regime. The floating exchange rate prevailing in the UK allowed an eventual autonomous relaxation of monetary policy. Furthermore, the policies in the UK were adopted to subdue an inflationary environment, not to combat deflation.

and would precipitate it.[79] Gaboriaud argued that the 1928 devaluation after the war had been different, it was a one-off adjustment to the post-war situation. He also argued that if the franc was devalued the florin and swiss franc would follow and there would be a renewed devaluation of the Belgian franc as well as the dollar and sterling. He was certainly proved right as far as the florin and swiss franc were concerned. And an article in L'Ordre (24/11/35) argued that the gold haemorrhage against the Laval government was an attempt to precipitate devaluation.

In Le Petit Journal, 28/5/35,[80] Marcel Déat, deputy for Paris and secretary general of the (neo-socialist) *Parti socialiste de France*, argued in favour of devaluation and against deflation. He supported giving the "*pleins pouvoir*" to Flandin (which were denied him) and argued that Patenôtre was right. Déat argued that only if activity recovered could the economy improve and revenues rise. And to achieve that the policy of deflation had to be abandoned. Increased activity would bring higher revenues in its wake, and the *rentiers* would be no worse off as a result of devaluation.[81]

G.Jèze in an article in the Journal des Finances, 31/5/35,[82] attributed the economic crisis to the political system and, though he rejected dictatorship, he argued in favour of substantial powers to implement policies aimed at balancing the budget and to defend the franc. However, to do so needed a resolute leader independent of interest and pressure groups. In his view speculation was a result of financial disorder which had been brought about by the political regime.

In a paper in the Journal des Finances, 5/7/35,[83] the International Chamber of Commerce pronounced itself in favour of free trade and stabilisation of exchanges on a gold basis. The paper argued that provisional measures for international stabilisation were needed

[79] Quoting Mitzakis, "*sachons qu'une loi d'embargo serait l'arrêt de mort du franc; elle équivaudrait fatalement à une dévaluation...*". source: L'Intransigeant, 26/11/35.

[80] source: B.F., 7/E 69 *politique monétaire, presse*, 1935.

[81] A credible devaluation accompanied by the necessary fiscal measures could lead to a relaxation of interest rates and a rise in the *rentes*.

[82] Quoting Jèze, "*Mais la spéculation n'est qu'un effet du désordre financier, lequel a été amené par le régime politique.*" (p.430).

[83] Bank of France, 7/E 69 *politique monétaire, presse*, 1935, 2nd semester. The paper was a report of a conference presided by E.Clémentel, senator and former minister, as well as founder-president of the C.C.I.

prior to arranging a more permanent stabilisation on gold and that an international conference should be held. However, Jèze though favouring stabilisation was against an international conference. He argued that only three currencies mattered, viz., sterling, the dollar, and the franc and that as currencies came off gold for domestic reasons an international conference would be a waste of time. As for the gold standard Jèze argued that the US was *de facto* on gold and that the UK must take the first step. The US could be expected to return *de jure*. Jèze argued that business needed confidence and confidence was dependent on a stable currency, and only a currency on gold could be stable.[84] Jèze argued that the key was the return of the UK to the gold standard and as it refused, the best option was to remain on gold and wait.[85]

During the financial crisis of 1935 J.Tannery, Governor of the Bank of France, argued, before the American Club, for a co-operative stabilisation of world currencies to stimulate trade and reduce uncertainty.[86] In his speech Tannery also defended the policy of the Bank discounting sound commercial bills,[87] though of course the Bank in 1935 was increasingly resorting to so-called "*avances occultes*," to bail out the Treasury. Tannery rejected devaluation as a possible course in an article for Le Jour, 11/7/35.[88] Tannery was obviously alluding to a unilateral devaluation, given his previously expressed support for international stabilisation, a euphemism for currency re-alignment/devaluation. Tannery pointed out that the Bank had the means to defend its currency. The fact that the Bank of France had the means to defend the currency due to its large gold holdings was part of the problem, as it allowed deflationary policy to continue for too long. In an article published in L'Excelsior (19/8/35) Tannery expressed the hope that confidence would return and that the 30bn. (*milliards*) French francs of notes and gold hoarded would be released to stimulate

[84] Quoting Jèze, "*1. Le monde des affaires a besoin de confiance; 2. la confiance suppose la stabilité de la monnaie; 3. la seule monnaie stable est celle qui repose sur l'or.*"

[85] see Journal des Finances, 5/7/35.

[86] Quoting Tannery, "*Le sort du monde dépend dans une large mesure d'une étroite coopération financière entre New York, Londres et Paris.*" (in, L'Homme Libre, 11/7/35).

[87] see Agence Economique et Financière, 11/7/35.

[88] Quoting Tannery, "*Ainsi que nous avons en maintesfois l'occasion de l'affirmer, nous sommes convaincus que, dans la situation actuelle du pays, une dévaluation de la sorte serait à la fois inique et vaine. Nous sommes résolus à défendre le franc contre toute attaque. Nous en avons les moyens; nous le considérons comme un devoir.*"

economic activity.

Substantiating our contention that orthodox policy makers were acting on the basis of a rationalised theoretical model, we find Marcel Régnier, Laval's Minister of Finance, arguing the case for deflation in an article in L'information (19/7/35). He argued that it was not just an "*esprit comptable*" that made them introduce economies, but "how could government reduce interest rates, which were so important for industrial recovery, if the government continued to tap capital markets?"[89] In other words the policy of deflation would reduce interest rates and so help industry and stimulate economic activity, and increase revenue. "How could one expect people to invest if they feared inflation and hoarded?" Régnier added that one could not expect capital to be invested if risks were such that liquidity would stand at a hefty premium.

In defence of the policy of deflation by decree J.Bainville of the *Académie Française* and prominent member of *Action Française*, argued that decrees deflating by 10% were less onerous than a devaluation which would probably amount to around 25% which would inevitably fall heaviest on the same sections of society.[90] A judgment with which the communists would have concurred. In Le Journal des Finances (19/7/35) these same arguments were adduced, as well as the need to maintain confidence to renew the floating debt. In an article in Le Petit Parisien,[91] Bainville pointed out that devaluation could not be expected to help balance the budget, viz., higher prices would lead to compensatory public sector wage demands. Gignoux also supported Laval's deflationary policies.[92] Laval was advised by J.Rueff, of the Treasury; R.Dautry, head of the French railways; and C.-J.Gignoux, editor of La Journée Industrielle and president of the *Fédération des Industriels et Commerçants Français*.[93]

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[89] Quoting Régnier, "*Comment penser à faire baisser le taux de l'intérêt, qui à une importance capitale pour tant d'entreprises si l'Etat restait perpétuellement emprunteur? Comment décider les capitaux thésaurisés à s'investir dans les affaires si chacun pouvait encore penser qu'il fallait garder liquides les resources dont il peut disposer pour parer au mieux aux répercussions de manipulations monétaires?*" q.v., crowding-out, this argument has a very contemporary resonance in supply-side economics.

[90] see Les Informations de Presse 19/7/35.

[91] see article of 14/7/35.

[92] see article in La Journée Industrielle, 24/7/35.

[93] see Mouré (1991) p.178.

In 1935 with governments facing financial crisis and treasury problems and a final effort at deflation being made, we find a spate of articles defending orthodox government policy against devaluation. M.Palmade, deputy and former minister, was amongst these. In Le Capital (19/8/35) he argued that price stability was needed in order to preserve the sanctity of contracts and that devaluation might lead to competitive devaluations leading to a fall in the world price level (a devaluation of international vehicle currencies, viz., sterling and the dollar could have this effect). Furthermore, the US authorities retained the ability to reduce the value of the dollar from its existing 59% of its former value to 50%. On top of this sterling, the Japanese yen, Scandinavian and Latin American currencies were all floating. Palmade reiterated his arguments in an article in Le Capital (22/11/35) and stated that any devaluation would have to be concerted to avoid retaliation.[94] He argued that the BIS should determine the new parities.

In an article in L'Homme Libre, Clovis Arel, argued that only deflation could restore confidence in the currency and create a climate of confidence which was necessary to foster savings which were essential to economic well-being (many inter-war financial commentators adhered to a similarly static loanable funds theory of savings and investment).[95]

Towards the end of 1935 L.Romier still adhered to the same orthodox views, rejecting devaluation. "Why has France fared badly?", he questioned, "because prices have risen." These had risen because of large budget deficits which increased the fiscal burden (*charges fiscales*) on industry and production. This impeded adjustment and led to protection which caused further price increases. The solution lay, not in devaluation, but, in the reduction of government expenditure.[96]

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[94] Quoting M.Palmade, "*Il serait imprudent au plus haut chef d'envisager par une décision de souveraineté interne une parité nouvelle sans s'être au préalable concerté avec les dirigeants des grandes monnaies. C'est seulement grâce à cet accord préalable qu'on pourrait éviter des représailles ou même des réflexes de défense, des glissements de quelques points de la livre, qui rendraient notre effort d'ajustement inutile.*"

[95] Quoting C.Arel, "*La pénible déflation à laquelle il nous a fallu nous résoudre, a permis de sauver le principal et de conserver une monnaie stable et convertible en métal précieux.*

"*C'était là le point central de tout redressement. Et de là tout doit découler logiquement: baisse des prix de gros, baisse des prix de détail, baisse du taux moyen de l'intérêt, baisse du chômage, baisse des faillites.*

"*Tout économie exige pour sa sécurité des réserves abondantes et épargne confiante. Or comment l'épargne garderait-elle la moindre confiance si la monnaie, commune mesure de toutes choses, n'était pas avant tout d'une stabilité absolue?*" (see B.F., 7/E 69).

[96] see his article in Le Figaro, 16/11/35.

In *Le Capital* (16/11/35) Germain-Martin, former Finance Minister and *membre de l'institut*, came out in support of deflation. He pointed out that the US had the ability to retaliate to a devaluation. However, by May 1936 Germain-Martin urged the Popular Front government to explore the possibility of exchange stabilisation, whilst rejecting devaluation. But, he appears to have had in mind some form of exchange controls to protect the external value of the franc. Caillaux also seems to have been leaning this way and suggested restrictions on gold movements as in Holland.[97] Caillaux rejected unilateral devaluation.

Emile Roche also rejected devaluation arguing that it was a breach of contractual arrangements.[98]

Caillaux, a few days before,[99] ironically inveighed against devaluation as hitting the lower classes and argued that any budgetary relief would only be felt in the first year and that thereafter one would have to return to deflationary policies, "so why abandon deflation in the first place?" Caillaux argued that the most likely prospect following a devaluation would be a further devaluation as it would be difficult to re-introduce deflationary policies and devaluation would appear the easier solution - how prescient he would be!

We find views similar to Caillaux's echoed in an article published in, *La Situation Economique et Financière*, 22/11/35.[100] This article is a particularly terse re-capitulation of the argument adduced against devaluation by the fiscally orthodox. It is argued that devaluation amounts to a tax on national wealth, similar to the wealth tax which the communists wanted to introduce. It was even more iniquitous as it penalised small savers and it only assured profits to speculators. It would bring temporary relief to the state (through a revaluation of the gold reserve). National wealth (*capital national*), this is

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[97] see Mouré (1991) pp.239-240.

[98] see *La République*, 18/11/35.

[99] see *La République*, 15/11/35.

[100] Quoting this article, "*La dévaluation est un prélèvement sur le capital national, au même titre que l'impôt du même nom, que veulent établir les communistes. C'est même l'impôt le plus inique, car il entraîne un appauvrissement de tous les détenteurs de francs et de tous les épargnants, en frappant plus lourdement les petits. Les bénéfices illusoires et temporaires qu'elle procurerait à l'Etat, ceux beaucoup plus certains qu'elle assurerait aux spéculateurs auraient pour contre-partie une perte de capital national. Celui-ci a déjà été suffisamment entamé depuis vingt ans: il convient de le ménager d'abord, de le reconstituer ensuite. Mais, pour cela, il n'y a qu'une politique financière: celle des économies, grâce auxquelles l'Etat ne surchargera pas encore les forces vives de l'économie. A ce prix seulement, la France pourra participer au redressement qui se dessine actuellement sur les marché mondiaux.*"

probably meant to be synonymous with savings, had already been sufficiently encroached over the last 20 years. Rather, it was necessary to rebuild it. To do so, one needed an economic policy characterised by reductions in expenditure. This would reduce the fiscal burden. Only then could France follow the recovery which had begun in the rest of the world.

Georges Bonnet, former Finance Minister and deputy, expressed his opposition to devaluation in a speech before the International Chamber of Commerce.[101] Bonnet argued that increased trade was needed to return to prosperity, but that trade had been hampered by protection. He argued that protection was introduced because of devaluations. A halt was therefore needed to this vicious circle and an international stabilisation agreement secured. Then trade barriers would come down.

An editorial in Aux Ecoutes de la Finance (13/7/35) argued both against devaluation and an international agreement on the grounds that the exchange rate is purely a national matter and that it was not possible to determine an actual parity in any case, as relative and absolute prices alter so rapidly.

Around the same time Rist, former, and now honorary, deputy-Governor of the Bank of France and academic economist who advocated circulation of gold coin in 1928,[102] argued that the decree laws did not reduce purchasing power as taxes were also reduced thus leaving purchasing power unchanged. As a result of these measures government crowding-out of savings would ease which would leave more resources in the personal sector to finance private investment. This is text-book supply-side economics.[103] Germain-Martin would adopt the same argument in defence of his record as Finance Minister. He argued that reductions in expenditure were appropriate as revenue increases would have diminished private sector income/expenditure.[104]

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[101] see L'Ere Nouvelle, 19/11/35.

[102] see Mouré (1991) p.138.

[103] Rist's views are reported in an article in La Vie Financière (1/8/35) quoting an article by Rist in, La Revue d'Economie Politique, 1934, in, B.F. 7/E 69.

[104] Quoting Germain-Martin (1936), "*Dans ces conditions, toutes nouvelle augmentations du taux des impôts devait se trouver fatalement à la charge du consommateur; elle avait pour conséquence de réduire d'autant le pouvoir d'achat du public et l'on peut donc affirmer que la politique des économies, loin de diminuer le pouvoir d'achat de la Nation, l'a augmenté, puisqu'il a permis de diminuer les impôts anciens, d'en éviter de nouveaux.*" pp. 255-56. And referring to the period 1931-32 and the crowding-out effects of a higher fiscal

M.Déat, neo-socialist leader continued to press the case for a devaluation. Arguing that in order for deflation to be successful one would need to deflate all contracts and resort to decrees and that the same results could be achieved more readily by means of devaluation. Déat argued that rapid recovery would follow devaluation.[105] Déat also underlined the need for state involvement in the running of the economy. However, he argued that attempts to underline differences amongst the pro-devaluation camp, in which Reynaud was more "liberal", constituted efforts to divide them. Déat quoted H.Clerc, who suggested that the communists were against devaluation so that the capitalist system might collapse! Certainly Laval's policy of deflation *à outrance*, in defence of economic liberalism, was, because of its unpopularity, directly instrumental in securing the electoral victory of the Popular Front!

As late as Spring 1936 the communists opposed devaluation. Duclos argued that devaluation was but a new trick to make the poor pay, i.e., by reducing real wages.[106]

Gradually though we see sentiment change and find Germain-Martin and Rist begin to accept the inevitable.[107] As of 15/5/36 Germain-Martin began to espouse devaluation as the export sector continued to suffer. The Popular Front, having won an election on a programme of increased expenditure, would have to be financed. The communists argued for a capital gains tax, but Germain-Martin felt that even this would not suffice and that inflation would follow and the franc fall. Implicitly it would appear that he was arguing in favour of a devaluation, "*à froid*," rather than have one forced on the government.[108]

In a couple of articles in Le Petit Parisien Rist accepted devaluation as inevitable.

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burden, "*De plus, le poids des impôts était tellement insupportable que toute aggravation aurait suscité les problèmes politiques les plus sérieux. L'impôt, toujours accru, n'a été que trop une cause de gêne pour les entreprises.*" *ibid.*, p.73.

This is similar to the Treasury-view which was opposed to government borrowing as it would crowd-out private investment. Quoting Hawtrey (1970), "The private demands on the capital market for internal investment would be diminished by the amount of the Government's demands." p.435. It was also thought that Government borrowing would raise interest rates and make debt conversion more difficult. As we can see this was a view shared by Germain-Martin.

[105] Quoting Déat, "*Je crois que la dévaluation procurera une détente rapide et durable, qui apaisera les esprits en amorçant une reprise économique incontestable.*" (in, La République, La Tribune Libre, 7/12/35).

[106] Duclos wrote in L'Humanité (15/5/36), "*A la vérité, nous savons, nous l'avons dit et répété, que la dévaluation du franc constituerait un moyen nouveau de faire payer les pauvres; or, nous ne voulons pas de cela, et c'est pourquoi il n'y a pas de plus résolus défenseurs du franc que les communistes.*"

[107] see Eichengreen Golden Fetters, p.376.

[108] see article in Le Capital - 25/5/36.

Rist thought that it would be better to go ahead before inflation of credit or paper money took place. He argued that the relative price disparity between France and the US and UK was too wide. Rist expected that such a devaluation would have beneficial effects by attracting a capital inflow, reducing interest rates, whilst the ensuing rise in securities would help stimulate investment.[109] According to Rist hoarding (*thésaurisation*) occurred because as interest rates rose bond prices fell and individuals preferred to remain liquid (a form of Keynesian liquidity trap, but with an inverse mechanism to Keynes'). It may be that this article and the following was preparing public opinion for the inevitable. An article in Les Echos (4/6/36) suggested the level of hoarded notes (*thésaurisation*) to be some 20-25 bn. (*milliards*) French francs.

Mouré argues that by 1936 Rist switched to support for devaluation admitting now that difficulties were economic in nature and not budgetary, as he had originally thought.[110]

In his letter in Le Petit Parisien (8/6/36) Rist argued that to maintain the franc at its existing parity would mean exchange controls and that to revive the economy the government would have to resort to inflation. Devaluation would prove inevitable. In the circumstances a devaluation now would be preferable and might avoid subsequent inflation. Jenny, the financial editor of Le Temps, opposed this policy arguing that devaluation was no panacea. However, he accepted that if the government could not implement orthodox policies then devaluation was inevitable.

Jèze in an article in, Le Journal des Finances,[111] alluded to the fact that devaluation was supported in some quarters because prices could not be directly adjusted. He pointed out that the argument was premised on the notion that prices would not rise, and expressed doubts that this would be the case. He argued that the reason Blum refused to devalue was because of the class aspect of the problem, as prices would rise and eradicate gains realised as a result of the Matignon agreements. In this context one should recall that the communists formed part of the Popular Front and were opposed to devaluation, which may well explain Blum's more forceful opposition to devaluation than in 1934.

[109] Quoting Rist, "*L'intérêt baissera automatiquement dès qu'une dévaluation rattachant le franc à la livre aura le triple effet (comme en Belgique) de rappeler les capitaux exportés, d'attirer les capitaux étrangers et, par la hausse des valeurs, de faire sortir à l'intérieur l'argent inemployé.*" in, Le Petit Parisien, 4/6/36.

[110] Mouré (1991) pp.238-239.

[111] see, "*La défense de la monnaie,*" 12/6/36.

Jenny reasserted his belief in financial orthodoxy in an article in Le Temps.[112] Jenny argued that Blum's policies would not reduce the deficit and that it would get larger. However, he recognised that if the government did resort to a reflationary policy then it would best to devalue, at least it would give them some lee-way. But, he pointed out that this would not resolve the underlying problem and that it would only lend temporary relief. He argued the case for deflation so that the economy might find a new equilibrium.

However, at the beginning of his term of office Blum continued to eschew devaluation, for which he was later to be much criticised. On 6th June Blum would make his oft-quoted statement that the country need not fear to wake up one morning to find placards on the streets announcing monetary surrender, viz., devaluation.[113] Blum would be castigated for not devaluing on coming to office. As so many erstwhile opponents of devaluation would come round to recommending.[114]

We know from subsequent statements by Blum's Finance Minister V.Auriol that they were waiting for an international agreement to devalue the franc. However, our research has shown that negotiations to this effect were going on even before the Popular Front acceded to power. Blum himself in a speech to the press stated that negotiations for a realignment with the US and UK had been taking place since June 1936.[115]

Maurras' Action Française predicted that a Popular Front government would lead to a flight of capital and devaluation, the only means by which government could secure fresh funds,- on the revalued gold reserves of the Bank of France.[116]

H.Clerc one of the main advocates of devaluation along with Reynaud and Déat, argued that his preference lay in abandoning the gold parity without immediately setting any

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[112] see, "*Chronique*" 22/6/36.

[113] Quoting Blum, "*Le pays n'a pas à attendre de nous, ni à redouter que nous couvrions un beau matin, les murs des affiches blanches d'un coup d'Etat monétaire.*" (speech by Blum as *Président du Conseil* reported in, Le Journal Officiel, 6/6/36).

[114] see chapter nine of this thesis.

[115] see Excelsior, 27/9/36, in B.F., 7/E 69, *politique monétaire, presse*, 1936.

[116] Quoting Action Française, "*Si les Français se laissent berner, si le Front Populaire est au pouvoir, son premier soin sera de dévaluer le franc, parce que les capitaux, justement effrayés, se dérobant, la dévaluation sera, pour lui le seul moyen de se procurer de l'argent frais.*" (29/3/36).

new parity.[117] Clerc was deputy of the Haute-Savoie and one of the monetary technicians of the Radical party.

A.-L.Jeune in Paris-Midi (11/6/36) suggested that Blum needed to devalue if the economy was to recover, profits rise, and allow French gold prices to adjust. He argued that the choice was either inflation or devaluation and that external pressure would eventually force devaluation in any case.

Even in, Le Rentiers (14/6/36), we find an article by E.Royot calling for devaluation given its inevitability and the need to protect the, gold, war-chest. Royot argued that the sooner one devalued the larger the state's profits realised on the gold stock. Devaluation could avoid economic and financial troubles bearing on the franc.

R.Courtin, Professor of Law at Montpellier, argued that devaluation was inevitable given government policy. L'Orientation published a disclaimer along with the article arguing that it had never supported devaluation (20/6/36). And Abel Gardey, a senator, cast doubt on the idea that resort to credit to finance the Popular Front's programme would not lead to inflation.[118]

In La République (16/6/36) Gerveille-Réache argued in favour of devaluation, as being in any case inevitable. In a later article referring to Auriol's demand for an extra 10bn. (*milliards*) French francs in advances, he applauded the fact that he was doing so openly, unlike the preceding governments, i.e, the Laval and Sarraut governments, which were supposedly pursuing deflationary policies and had issued 14bn. French francs worth of Treasury bills/bonds. He also pointed to the inflationary post-war policies of the "*chambre bleu-horizon.*" Apparently he fully supported devaluation in the Annual Survey of the French economy published in the Revue d'Economie Politique. His stance was highly criticised in, Commentaires (6/9/36).[119]

Following the devaluation of September 1936,- or "realignment" as the government preferred to call it, which it was in a sense as the real exchange rate had appreciated considerably since 1926 (i.e., relative domestic gold prices had risen),- Reynaud called on

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[117] Quoting Clerc, "*C'est au simple abandon de l'étalon-or sans parité immédiatement que vont mes préférences, malgré les inconvénients que peut présenter ce système.*" From, L'Information, 10/6/36.

[118] see L'Ere Nouvelle, 21/6/36.

[119] see B.F., 7/E 69.

the government to balance the budget to reap the benefits that could be secured from devaluation and avoid policies which would lead to price rises, a renewal of the crisis, increased unemployment and possible strain on the franc.[120]

Germain-Martin was critical of the social policies of the Popular Front, arguing that they would throw-away any benefits to be derived from devaluation. Prices would rise and at the end of the day devaluation would only have altered nominal values.[121] Of course, if one subscribes to a debt deflation theory of the depression this could only be welcome. Certainly the "anglo-saxon" economists were particularly concerned to raise the price level, both domestically and internationally (i.e., wholesale and commodity prices).

A.Tardieu was to be particularly critical of what he saw as duplicity on the devaluation issue on the part of the Popular Front. Writing in _Gringoire_ (2/10/36) he condemned the Popular Front for having lied about devaluation, whilst preparing it, and for introducing policies which it did not have the means to implement. Tardieu also argued that the franc was not stabilised, despite the devaluation, as it was in fact aligned against floating currencies. He also attacked the Popular Front for encouraging the public to subscribe to loans (Auriol bonds), on which they had part-defaulted by devaluing. He was very dismissive of the Popular Front.

Tardieu's opinion on the devaluation issue seems to have been largely shared by Jèze who strongly condemned the bankruptcy of the state which devaluation represented. Jèze still advocated deflation as the best method to adjust. He was scathing about the expropriation on the newly issued loans and the lies about devaluation on the part of the Popular Front.[122] These views were echoed in the Chamber of Deputies during the devaluation debate.[123]

A general reading of internal policy documents, in particular within the Ministry of Finance, indicates that officials were often more willing to consider devaluation,- albeit in the context of a general stabilisation of currencies, than the press. Orthodox politicians were often the author's of these press articles. However, the strident opposition to devaluation

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[120] see _Le Journal_, 1/10/36.

[121] Quoting Germain-Martin (1936), "*Mais les mesures sociales ne vont-elles pas entraîner une hausse des prix? Si elle se produisait, n'aurait-on pas fait une opération purement nominale. La hausse du coût de la vie risquerait d'annuler tous les avantages obtenus.*" p.377.

[122] see _Journal des Finances_, 2/10/36.

[123] see chapter nine of this thesis.

sometimes struck in the press, was in part determined by a desire not to shake confidence in the franc.

V.Auriol was to claim when the devaluation of the franc was announced, that an international stabilisation agreement had been an objective of French monetary policy since the 1933 London World Economic Conference. This was indeed the case.

A series of internal papers prepared by the Bank of France for the Finance Ministry provide a particularly succinct summary of the "official" reasoning behind the rejection of devaluation as a unilateral policy option. One of these papers was prepared as a response to an article by W.Lippmann published in the Paris edition of the New York Herald Tribune on 17/2/34.

In the first of these papers it was argued that France was perfectly capable of defending the parity of the franc,[124] pointing to the fact that the gold cover amounted to 77% of sight liabilities and current accounts. This illustrates the extent to which policy-makers were blinded by France's large gold stocks, whilst ignoring the macro-economic consequences of the deflationary policies consequent on an over-valued exchange rate. The paper quoted, approvingly, G.Doumergue who, as *Président du Conseil*, declared in the Chamber of Deputies on 22/2/34, that the franc represented the fruit of the workers' labour, his savings, the security of family, his future and insurance against old age.[125]

The paper went-on to argue that experience had shown that devaluation would lead to a rise in prices and an arbitrary redistribution of wealth from creditors to debtors, and the threat of devaluation would be enough to spark a speculative run into real values and out of the currency. The paper argued that experience had shown this to be the case.[126] The danger of capital flight was particularly acute in a country with substantial hoards of liquid cash. It is a central tenet of this thesis that historical experience and its interpretation are

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[124] *Note du* 24/3/34, B.F., 4/N 383.

[125] Quoting Doumergue, "...*la valeur du franc représente en effet son travail* (here he is referring to the workers), *son esprit d'économie, la sécurité de sa famille, son avenire, ses espérances pour la vieillesse.*" (*op.cit.*, p.3).

[126] "*L'expérience a enseigné au public français les conséquences d'une dépréciation de la monnaie. Il sait que cette mesure engendre normalement la hausse des prix, qu'elle favorise les débiteurs au détriment des créanciers et qu'elle provoque un renchérissement de toutes les valeurs réelles. La seule menace d'une dévaluation suffirait-elle pour déterminer de vastes mouvements spéculatifs particulièrement redoutables dans un pays comme la France, où une masse importante de capitaux est actuellement disponible.*" (*op.cit.*, in, *Note du* 24/3/34, B.F., 4/N 383, p.4).

crucial to understanding inter-war French policy action. This paper validates this opinion.

The paper argued that France's balance of payments deficit remained sustainable and it went-on to contrast the situation in France with that in the US. It averred that the US had to devalue because of substantial private sector indebtedness, whilst in France the government was the main debtor and its liabilities represented substantial private sector assets.[127] The paper points out that personal indebtedness in the US was some three and a half times higher than in France.

The paper argued that, contrary to a belief holding wide currency, devaluation would not reduce domestic prices as these were due to agricultural protection. What is more devaluation might be followed by dishoarding of some 25bn. (*milliards*) French francs of notes or some one third of the circulation. These would cause a flight into real values and might well cause prices to rise further than the rate of devaluation. This would be followed by a rise in wages, particularly as some contracts included an indexation clause. Though it denied any long term export advantage to be derived from devaluation, in the short term France would gain an advantage to the detriment of the US and UK. However, devaluation would turn the terms of trade against France and would mean that imports would have to be cut back. And, finally, a devaluation of the franc would bring down, in its wake, the remaining gold currencies and could lead to competitive devaluations.

Two further papers prepared by the Bank of France, "*Les conséquences d'une dévaluation du franc*," and, "*L'erreur de la dévaluation*," rehearse the same sort of arguments, whilst developing certain points a little further.[128]

These argued that a devaluation would turn the internal terms of trade against the agricultural sector and curtail their living standards,[129] a significant argument given the

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[127] One must recall that in the absence of any extensive social provisions private sector savings would represent the virtual sole security available in case of need, or to fund retirement.

[128] see B.F., box, 4/N 383.

[129] "*...l' agriculture ne bénéficierait pas de la baisse du franc, puisque la plus grande partie de ses débouchés sont à l'intérieur, et que, par suite du décalage entre les prix des produits agricoles en France et à l'étranger, une dévaluation de la monnaie n'améliorerait pas ses possibilités d'exportation. Le paysan français serait donc obligé de payer plus cher les vêtements, les machines, les outils qui lui sont nécessaires, tandis que les prix de ses produits resteront stationnaires. Son pouvoir d'achat diminuerait comme celui des salariés et des rentiers. Une dévaluation du franc imposerait ainsi à une catégorie du public, de lourds sacrifices, puisqu'elle les obligerait à restreindre leur train de vie.*" (*op.cit.*, p.4). The argument here hinges on the fact that agricultural prices were above the world level and would not rise following a devaluation whilst the price of manufactureds would, as a result there would be a relative decline in the internal terms of trade of

political weight of the agricultural sector. A constituency which the radical-socialists, in particular, represented.

These papers argued that devaluation could be expected to be followed by compensatory wage demands, given the association in the public consciousness of currency depreciation and inflation resulting from the experience of the 1920s. Should these demands be resisted strikes could be expected. Devaluation would erode public credit and make it impossible for the state and industry to raise capital, it could also provoke a withdrawal of deposits in banks and savings institutions. The paper also pointed out that exports amongst Gold Bloc countries had not fallen as steeply as those of the main countries that had devalued, the former witnessing an average fall in export earnings in gold dollars of 64% in 1934 compared to 1929, whilst the latter experienced a drop of 71%.[130] The paper alluded to the much lower rates of unemployment in Gold Bloc states. Any devaluations could well be followed by tariffs and compensatory surcharges on French exports, just as France had responded to UK devaluation.

With the benefit of hindsight the paper made a particularly cogent point arguing that a devaluation would create large paper profits on the Bank of France's gold stock which would accrue to the Treasury. These would be directly monetised and could create on the basis of a 25% devaluation profits of 30bn. (*milliards*) French francs which would increase the note circulation from 100bn. to 130bn. (*milliards*) French francs. This would be inflationary and could well result in a process of continuous inflation.[131] This argument is somewhat disingenuous as much of the potential profits that could be secured on the revaluation of the Bank of France's gold stock had already been mortgaged by the preceding governments, to the tune of 14bn. (*milliards*) French francs. The paper concluded that the crisis was not monetary in origin, but due to a disequilibrium between production and consumption and that devaluation by adding to international monetary chaos would only make a return to equilibrium all the harder.[132]

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the agricultural sector.

[130] op.cit., p. 5.

[131] op.cit., p.11.

[132] "*La crise est due à un déséquilibre entre la production et la consommation. Les altérations monétaires, en aggravant le désordre international, contribuent à retarder l'heure de l'ajustement.*" (op.cit., p.17). This analysis conforms to an "Austrian" interpretation of the trade cycle see v.Hayek (1934, and 1966); and v.Mises

CONCLUSION:

This chapter, drawing heavily on original documents, and the work of Mouré (1991), should help dispel the view that French policy-makers were making policy on the hoof, with no properly articulated theoretical paradigm or model to inform their decisions. Nothing could be further from the truth, and it is apparent from a reading of, e.g., Germain-Martin that his motivations for maintaining the franc's gold parity were fully reasoned and soundly based. One could argue that the opponents of devaluation who thought that it would cause: inflation; continued exchange depreciation; and be followed by serial devaluations; and would fail to secure any permanent improvement in the government's fiscal position, were amply vindicated.

In today's intellectual climate which tends to favour fixed exchange rates, their arguments may well receive more favourable treatment. As is so often the case the arguments in favour of fiscal orthodoxy are too often dismissed as unsophisticated because the economic historians are only vaguely familiar with the arguments through secondary sources. The main charge which can be brought against the orthodox view is its preoccupation with the exchanges and the gold cover, whilst not recognising the increased rigidity of nominal values (Keynes' key insight) and the well-nigh impossible task of deflating in the face of such substantial devaluations of the competitor currencies, as well as the cumulatively perverse macro-economic effects of deflation.

The pro-devaluation camp did not provide such a coherent intellectual argument in favour, and this allowed such analysts and political figures as Germain-Martin to point to the contradictions in their case, i.e., "would devaluation stimulate exports by lowering export prices, or, would it generate increased economic activity and revenue as prices rose?" Further, those opposing devaluation on the grounds that an international stabilisation accord would be needed first did have a sound point. However, it is undoubtedly the case, with the benefit of hindsight, that if Reynaud's policy prescriptions had been followed, viz., a planned devaluation along with a fiscal package aimed at balancing the budget (in part to secure confidence), along with supply-side measures the economy and currency could possibly have avoided the Laval deflation of 1935, which helped secure the electoral victory of the Popular

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(1971).

[redacted]omic crisis which would last till [redacted]

[redacted]ter under Daladier.

CHAPTER 8

NEGOTIATING STABILISATION (1934-36) AND THE TRIPARTITE AGREEMENT

This chapter analyses the course of the negotiations which led to the Tripartite Agreement of September 1936. This agreement constituted a tacit commitment not to retaliate against a French franc devaluation. This devaluation was dressed up under the guise of a realignment within a general stabilisation agreement. However, as Drummond has pointed out it did not include any specific exchange rate commitments and the period following the Agreement saw significant exchange rate movements. Though, as Eichengreen points out it did solidify the dollar price of gold at $35 an oz.[1]

It is perhaps useful to note that stabilisation had different meanings at different times. In the period 1933-34 it principally concerned stabilising the value of the dollar. By early 1935 the French authorities were concerned to stabilise currencies as sterling weakness was putting pressure on Flandin's domestic economic policy programme. And by mid-1935 the expression was increasingly understood to mean an international agreement which would allow an orderly devaluation of the franc.

Clarke (1977) noted that towards the end of 1933 the US was sending out feelers according to which, "The French were expected to maintain the franc at the gold value established by the Poincaré government in June 1928, and the percentage devaluation against gold could be no larger for sterling than for the dollar. The administration would try for a sterling-dollar rate of $5.00 or above; it would accept none lower than the old parity of $4.86."[2] Clarke records that the US would only agree to stabilise if the UK would make a similar commitment. Montagu Norman is quoted as saying that there was no prospect of this and that he considered the dollar undervalued.

In the event the US authorities continued to depreciate the dollar (increasing the purchase price of gold) till Roosevelt *de facto* stabilised at $35 per oz. in January 1934.

Official sources reveal that the US had become more willing to consider currency

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[1] Golden Fetters, p.380.

[2] Clarke (1977), p.3.

stabilisation, viz., fixing exchange rates, at the end of 1934. Eichengreen attributes this to the negative effects which currency instability was deemed to have on economic recovery, and concern in the US as prices rose and kindled fears of inflation.[3] A speech delivered by Treasury Secretary Morgenthau on 13th May 1935 appears to have revived the idea. At least this was the considered view of French policy-makers. The British, according to French sources, took a different view of the US initiative, viz., that it would allow the US to shift the blame for failure on the UK. The UK appears to have attached less importance to US overtures. However, what is clear from official sources is that the UK was very reluctant to enter into any fixed exchange rate commitment, particularly ahead of the general election of 1935, and embark on negotiations which might lead to Franco-American pressure for some commitment to stabilise sterling.[4] Though Eichengreen adds that the UK would be interested in an agreed French devaluation as this would prevent retaliatory US action which would prompt a British response.[5]

The UK would also invoke the difficulty of settling on an acceptable stabilisation parity, wanting a rate below the old parity of $4.86 to the pound. Too low an exchange rate would meet with resistance from the US. The problem would be compounded by the difficulty of establishing a suitable cross-rate against the franc. The British authorities admitted that sterling was undervalued against the franc. However, as Leith-Ross pointed out, a rate close to the estimated purchasing power parity of 85 francs would yield a sterling/dollar rate of $5.60 to the pound. Though Leith-Ross's point is well taken, it is rather specious because policy-makers assumed that stabilisation would be used as an opportunity to devalue the French franc. As we will see the UK accepted the Tripartite and devaluation of the franc when this had become inevitable. The original French draft Tripartite statement was not accepted and the UK statement excluded all reference to a future role for gold as the anchor of the international monetary system. Domestic economic conditions were emphasised as the ultimate determinant of monetary policy,- as opposed to any fixed exchange rate commitment.[6]

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[3] see Golden Fetters, p.378.

[4] see Golden Fetters, p.378.

[5] see Golden Fetters, p.378.

[6] see documentary Appendix.

The first indications that the US was intent on stabilising its currency (i.e., a *de jure* return to a fixed gold parity) are recorded in a note from Appert to the Ministry of Finance dated 8/9/34.[7] This was drafted as a reply to an earlier letter recording the Bank of England's concern about the dollar. Appert records that President Roosevelt had informed Flandin that the US Treasury had intervened to support the dollar and that the US was getting ready to stabilise its currency. Appert interprets US policy as aimed at preventing the dollar weakening along with sterling and to prepare the ground for debt conversion operations and Treasury operations in September and October. Government paper had been weakening somewhat and apparently the banks had been unwilling to purchase new issues. Hence, the need to stabilise the dollar to restore confidence in gilt-edged stock which would have to be issued to fund the public expenditure programme. However, Appert warned that it was still impossible to foresee when stabilisation would take place and whether or not it would be below the then prevailing rate of exchange. Appert adds a further rider warning that one could not be sure that the President under economic or political pressure, might not change his mind again. This confirms the unreliability which both French and UK policy-makers ascribed to Roosevelt.

A very useful source, which underlines some of the difficulties which would be a recurrent feature in reaching a stabilisation agreement, is a "strictly confidential" memorandum of 22nd November 1934 from Monick (the French Financial Attaché in London) to the Ministry of Finance.[8]

Monick argued that the idea of currency stabilisation had begun to gain some favour since the failure of the World Economic Conference, which had marked the nadir of co-operation, and that the memorandum would provide a suitable opportunity to review the

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[7] Quoting Appert, 8/9/34, MF B 32 323, "*... et si le Président sous la pression des circonstances économiques ou politiques ne changera pas encore une fois d'opinion à son sujet.*"

[8] M.F., B 32 324, "*L'opinion de la Grande-Bretagne au sujet du problème de la stabilisation des monnaies,*" memorandum by Monick. Some of these difficulties are recorded in Mouré (1991), though they apply to the third quarter of 1935 they nonetheless illustrate the abiding difficulties associated with attempts at realising an acceptable stabilisation. Quoting Mouré, "There was a growing conviction among French policy makers that a devaluation was needed in a domestic political scene where few dared to support it publicly and with no means of achieving it because it was acceptable only as part of a general stabilization agreement no one was prepared to propose. The British were in no hurry to stabilize, and the Americans had no wish to have proposals spurned by the British. The French wanted a retreat with honor from defense of the franc and a restoration of the stability the gold standard was supposed to guarantee. These attitudes would constrict French policy until devaluation could no longer be postponed." *op.cit.*, p.236.

UK's attitude to the question. Its conclusions are based on enquiries he conducted in the City and at the Treasury, notably with Sir Frederick Leith-Ross (economic adviser to the H.M.'s Government).

Leith-Ross had developed the following argument. He pointed out that though the UK was sometimes blamed for its unwillingness to peg sterling to gold this was due to a failure to understand the delicate position of sterling caught between the dollar and the Gold Bloc. Leith-Ross argued that it was clear the dollar was undervalued *vis-à-vis* sterling and the UK would not agree to endorse the existing exchange parity of $5 to the pound. According to Leith-Ross this rate was wholly artificial and maintained by the actions of the US exchange equalisation account which bought gold and sold dollars for French francs and sterling. The fact that the US had imported $1 billion worth of gold since the beginning of the year was proof enough of the undervaluation of the dollar.

Monick enquired as to the reaction of H.M.'s Government should the US agree to the old parity of $4.86 and relinquish the Presidential authority to further devalue the dollar to 50% of its former gold value. Leith-Ross replied that H.M.'s Government would be very cautious, that the old parity did not correspond to purchasing power parity and that sterling's real value should not exceed $4.50. The exchange rate question remained very important to the UK as otherwise she would find herself in the same situation as in 1925.

This demonstrates the extent to which historical experience impacted on policy-making, the UK being traumatised by the experience with post-war stabilisation and France keen to avoid the post-war experience of inflation and currency depreciation.

Leith-Ross argued that at the old parity capital would flow to the US, sterling would fall to its gold export point, and gold would follow the outward movement. In order to avoid this the UK would have to introduce a deflationary policy and the UK did not want to repeat this experience. Experience between 1925-31 had taught the UK authorities that any forceful deflationary policy was not practicable in the UK, nor for that matter in any other democracy. This judgement proved correct as those parliamentary regimes which pursued deflation in the 1930s surrendered powers to the executive to deflate by decree or acquired fascist governments.

Leith-Ross added that there would be no guarantee that stabilisation would last. Roosevelt was guided first and foremost by domestic political considerations. If prices did not to rise following stabilisation the newly elected Congress would demand a further devaluation of the dollar. And according to Leith-Ross the President was not the kind of man to resist such pressure. If one recalled the careless way in which he abandoned the gold standard it demonstrated that in difficult circumstances international considerations would not be upper-most. This is worth quoting in the original as it vindicates my contention that Roosevelt's opportunism was a source of deep suspicion and disquiet in both France and the UK and made a stabilisation agreement harder to reach. *"Le Président ne serait pas homme à résister à une telle pression. La façon désinvolte dont il a abandonné le "gold standard" montre assez que les considérations internationales ne seraient pas celles qui, dans des circonstances difficiles, emporteraient sa décision."*[9]

Leith-Ross argued that it would be up to the US to demonstrate its willingness to stabilise before inviting others to do so. The US should first re-establish internal confidence in its currency whilst maintaining the existing parity of the dollar and pursue a policy aimed at raising domestic prices. Only then would they have set the groundwork for a successful stabilisation both domestically and internationally.

However, Leith-Ross argued that *vis-à-vis* the Gold Bloc the position was quite the reverse with sterling being under-valued. Nevertheless, because of the exaggerated depreciation of the dollar the UK could do nothing about it. Any adjustment of sterling against the Gold Bloc currencies would only increase the disequilibrium between sterling and the dollar. In order to re-establish purchasing power parity with the franc sterling would have to rise to some 85 francs, however this would yield a "cable" rate of $5.60.

Alluding to the Belgian situation Leith-Ross let it be known that H.M.'s Government would not adopt retaliatory tariff measures should Belgium devalue, as long as the rate chosen was sufficient to restore purchasing power parity. However, given the price deflation already achieved in Belgium the UK could not accept a return to the old parity, viz., 175 francs. Leith-Ross added that however justified such a devaluation would be he did not wish it for the time being. However, Leith-Ross added on a pessimistic note that adjustment in foreign exchange markets would not be achieved by means of international agreement, the time for this had been the World Economic Conference and it had passed. Adjustment would occur *de facto* under the pressure of economic circumstance. His judgement would be largely vindicated by events, the Tripartite Agreement would be little more than a recognition

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[9] Monick, ibid.

of an existing state of fact rather than a carefully crafted prelude to economic disarmament.[10]

Monick goes on to interpret his exchange with Leith-Ross. According to Monick Leith-Ross had presented H.M. Government's official policy line, not what would be the *de facto* conditions of stabilisation. The exchange rate of $4.50 was not endorsed by the authoritative British media. The Economist was quoting a figure of $4.65, whilst the City did not dismiss the old parity of $4.86 so long as Roosevelt could give guarantees of his *bona fides*. Monick interpreted this to suggest that it was not so much technical questions such as the exchange rate which really worried the UK, but rather the general uncertainty prevailing. There were political uncertainties in Europe and the economic situation in the US remained as yet unresolved. The US budget deficit could well foreshadow inflation,- how far removed from reality this judgement appears! And Roosevelt's constant policy-shifts meant that the UK was very wary of any commitments which the US might undertake concerning currency stabilisation.[11] Monick points out that a stabilisation agreement which excluded Japan and Germany might be more disadvantageous than advantageous to the UK. It is hard to follow the argument here though, particularly in the case of Germany which had already embarked on its peculiar isolationist political and economic policy.

Monick suggested that the excuse of uncertain international circumstances might well be a pretext to cover the indecision of the National government ahead of parliamentary elections,- held in October 1935. UK public opinion did not want a change of monetary regime.[12] According to Monick, UK policy-makers also thought that if sterling were to return to gold it could lose some of its attraction to both Australia and Canada from which the dollar would benefit. Drummond has argued that the reason that the sterling area proved attractive was that it was because of low rates of interest set within the area with the

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[10] Quoting Drummond (1981) on Leith-Ross's views concerning the Tripartite, "Leith-Ross had this to say concerning the Tripartite declaration which other countries such as, Czecho-Slovakia, Switzerland, Denmark, Holland, and Belgium applied to join after the French devaluation, "We can scarcely explain to them that the high-sounding terms of the Declaration were simply put in to help the French Government with their domestic political troubles and mean nothing." p.222.

[11] Quoting Monick, ibid., "*...les rapides évolutions du Président Roosevelt ont laissé à Londres une profonde méfiance dans la valeur des engagements que les Etats-Unis pourraient être appelés à prendre au sujet d'une stabilisation des monnaies.*"

[12] Quoting Monick, "*...il faut le rappeler une fois de plus, l'opinion publique en Angleterre ne souhaite, pour l'instant, aucune modification dans son régime monétaire.*"

Treasury's low bank rate acting as a benchmark. This opinion is shared by Eichengreen.[13] The reference to Canada, though, is somewhat erroneous as the Canadian dollar was floating against a sterling/dollar basket in which both currencies held equal weights.[14] Monick goes on to suggest that the very idea of currency stabilisation to British policy-makers smacked of entanglement.[15]

Monick concluded that the UK would not take an initiative in favour of stabilisation. This did not mean that it would reject such a proposal out of hand, particularly if it came from the US. He noted that the UK domestic situation could change and make a stabilisation agreement more likely. So far sterling had been relatively insulated from exchange fluctuations due to political uncertainty, but uncertainty could begin to have an impact on sterling and lead to a shift in attitude. Monick argued that sterling's weakness could give a further impulse to price rises and lead to compensatory wage demands. However, this was a misreading of the British stance as the Treasury would probably have welcomed an upward movement in prices. However, Monick argued that uncertainty ahead of the elections could weaken sterling and precipitate wage demands which would not be desirable in an election year. This could cause a shift in public opinion on the questions of stabilisation and a return to the gold standard. As government policy was dictated by public opinion it could lead to a reversal of policy. However, this appears to be both optimistic and a singular misreading of British policy. Any negotiations ahead of the elections might well take too long and the British government would be foolish to compromise its cheap money policy in favour of the discredited policy of deflation. Furthermore, as far as confidence in the currency was concerned the UK government's fiscal stance was sound and the government ran a balanced budget,- which is more than could be said of France. If anybody should have been worried about currency instability it was surely France.

The first tentative soundings by the US government on the stabilisation question are recorded in a report of a meeting held between French Ambassador, de Laboulaye, and

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[13] see Golden Fetters.

[14] see Eichengreen (1992).

[15] Quoting Monick, "*...la stabilisation lui paraît entachée aujourd'hui d'un soupçon "d'entanglement".*"

Secretary of State Cordell Hull dated 9/1/35.[16] The meeting took place on the 2nd January and was ostensibly concerned with the preliminary discussions between France and the US which aimed to secure a commercial agreement. Secretary of State Cordell Hull outlined his desire to reach a commercial agreement based on liberal economic policies negotiated on a bilateral basis,- something of a contradiction in terms. The Secretary of State, in reference to Neville Chamberlain's statement that sterling and the dollar could not be stabilised until the dollar/franc rate had been definitively fixed, quizzed the French Ambassador on France's attitude should the sterling/dollar exchange rate be stabilised at its old parity of $4.86. Secretary Hull added that there was no question that this would happen in the immediate future.

In reply, de Laboulaye who is reported to have been rather taken aback by the question, answered that previous French governments had been categorical on the question of the franc's gold value and that there was no reason to believe that the stabilisation of two currencies off gold should alter this. Cordell Hull stated that he well understood the political motives in such a stance, but that from an economic perspective it was less clear cut. However, in his report de Laboulaye warns that Cordell Hull's questions were merely personal soundings and were in no way precursor to an invitation to engage in a more in-depth dialogue. This is, perhaps, to dismiss Cordell Hull's approach a little too lightly, particularly if one compares this with Roosevelt's former intransigence. Of course, before and during the London Conference the US delegates had evinced a more positive attitude on the question of stabilisation to be subsequently rudely confounded by Roosevelt's "bombshell."

The question of currency stabilisation was the subject of a report dated 13/1/35 from the Ministry of Foreign Affairs to the Ministry of Finance reporting on the most recent US statements on the question.[17] At a press conference held on 9th January President Roosevelt had declared that it was the State Department's belief that the Gold Bloc would soon launch an initiative aimed at securing currency stabilisation,- confirming earlier reports. According to the <u>New York Times</u>, the French delegation would discuss stabilisation at their London

[16] see: "*Conversation de notre Ambassadeur à Washington et du Secrétaire d'Etat sur la politique monétaire,*" dated 9/1/35, M.F., B 32 324.

[17] see: "*Stabilisation Monétaire Internationale.*" M.F., B 32 324.

meeting with British ministers at the end of January. The State Department is reported to have stated that the US government had not been approached on this question by either France or any other state and that the US government, whilst closely monitoring developments, would not take any initiatives. According to the New York Times if a decision had to be taken Roosevelt would not only have to take into account international factors, but also domestic ones,- in particular if the Gold Bloc countries devalued and proposed stabilisation under conditions which would tend to be deflationary (e.g., leave the US dollar over-valued). This story was also confirmed in the Financial Times. And according to the Daily Express, which reported statements made by Roosevelt at the White House on 9/1/35, both the Netherlands and France would soon approach the UK on the feasibility of inviting the US to a conference on currency stabilisation. The French representative in London warned that any leaks would undermine the negotiations, spark controversy and leave the British government little freedom of action. The report confirmed the agreement between the Ministry for Foreign Affairs and the Ministry of Finance not to deny, if asked, that they were discussing currency stabilisation, but that they would assert that no preliminary agreement had been reached with any foreign government. This report demonstrates how sensitive the topic had become in the UK.

The Foreign Ministry continued to be worried about leaks. The note of 17/1/35[18] referred to several press articles and the fact that the Cordell Hull/de Laboulaye meeting had been reported in the New York Times. The article suggested that these talks had encouraged a French initiative. The New York Times correspondent in London had reported, on 13th January, that Prime Minister, Flandin, had suggested that monetary stabilisation be on the agenda at the forthcoming London meeting. But, that whilst the British government did not reject this suggestion it expressed the view that it did not expect results to issue from such discussions. According to the article the French Prime Minister was referred to Neville Chamberlain's latest statements on the matter, viz., no sterling stabilisation could be envisaged until the dollar and franc had been stabilised. The Foreign Ministry note also referred to an article published on the same day in the New York Times (by Mr. James) according to which France would be willing to reduce the gold value of the franc as part of a stabilisation agreement. However, it also records that the US's hands would remain tied

[18] see: "*Stabilisation monétaire internationale.*" M.F., B 323 323

on the issue until the Supreme Court had delivered its judgement on the gold clause. A judgement in favour of the Government (i.e., abrogation of the gold clause) would allow the US government to undertake specific commitments on the matter of currency stabilisation.

A note dated 17/1/35, from Monick, is of particular interest.[19] In it he reported the US view on currency stabilisation (communicated by his US counterpart in London). The US Economic Attaché stated that the US government was in principle in favour of discussions on the topic of exchange stabilisation and that the *de facto* exchange stability which had prevailed for some time afforded an ideal opportunity for this. However, he added that the US government would not initiate discussions with the British government. The US view being that the British government had no intention for the time being of stabilising sterling and that the US government did not wish to be rebuffed.[20] This is of particular interest as it indicates the substantial shift in the UK's stance since the 1933 World Economic Conference. The UK having benefited substantially from living under a managed float, and still suffering from the trauma of post-war stabilisation, was not willing to undertake a fixed exchange rate commitment, whilst the US stance appears to have become more accommodating on the issue.

However, the US Economic Attaché stressed that should Flandin's forthcoming London meeting elicit a favourable reaction from the British government on the question of currency stabilisation, then the US government would be willing to study the matter. The US government would not make the question of inter-allied debts a precondition of the talks nor the old sterling/dollar exchange rate parity. The sterling/dollar exchange rate would have to be the subject of a statistical study. The US Attaché could not say whether or not the question of debts might be raised during discussions.[21]

An undated section of a paper by Monick which was drafted about the same time,[22] ahead of Prime Minister Flandin's London meeting, reports an article in the Financial News

[19] see: M.F., B 32 323, 17/1/35.

[20] Quoting Monick, "*Il craint, en effet, que le Gouvernement britannique n'ait aucune intention actuellement de stabiliser la livre, et il ne veut pas courir le risque d'un nouveau refus.*" M.F., B 32 323, 17/1/35.

[21] Quoting Monick, ibid., on the US government's stance,"...*au cas où le Gouvernement britannique ferait preuve à cette occasion d'une réelle et formelle intention d'envisager des mesures pouvant aider à la stabilisation des changes*." (underlined in the original).

[22] see: M.F., B 32 324, p.5.

according to which the Flandin visit would be used as an opportunity to discuss stabilisation. It argued that Flandin as a former Finance Minister was perfectly equipped to negotiate and that Germain-Martin, the Minister of Finance, had prepared a complete dossier for him. Though the Financial News pointed out that there was little prospect that the UK would wish to return to gold, the meeting would provide a useful opportunity to set out each government's position. However, the Financial News also pointed out that as Flandin's meeting would take place before the US Supreme Court delivered its judgement on the gold clause, on February 4th, it was not the best of times to discuss stabilisation with the British authorities. In the circumstances should the French authorities be secretly considering devaluation it would be best not to make a public avowal of this for the time being. The article concludes that Flandin should wait to see the results of his new monetary policy and whether there was any prospect of a rise in world prices.

There appears to be no further material on Flandin's visit on the French side. Clarke (1977) argues that his London visit was prompted by sterling weakness which was undermining his economic policy. Flandin wanted to secure some form of stabilisation agreement. But the British authorities would have none of it. Leith-Ross argued that sterling weakness was due to economic disequilibrium and protection. Flandin's proposed trade relaxation measures should come before stabilisation. Following the London meeting sterling continued to weaken and Lacour-Gayet of the Bank of France proposed a Franco-American stabilisation fund to support sterling. But the US were not keen and one must assume that the British government would have refused in any case.

A draft report prepared by Monick on 8/3/35, which provides an assessment of the British position argued that the government would be unwilling to tie its hands ahead of the coming general election. Monick's paper is a critical evaluation of a statement delivered by the Chancellor of the Exchequer to the House of Commons,[23] on 7/3/35, on the question of currency stabilisation. Monick underlined that Chamberlain's speech was of interest to the French government. It had been prompted by the recent weakness of sterling and by questions concerning the National Government's policies. Sterling's weakness in March 1935 was, as we have seen in chapter six, the proximate cause of Belgium's devaluation.

According to the Chancellor of the Exchequer it would be manifestly impossible, in

[23] see: M.F., B 32 324.

the existing circumstances, to tie sterling to gold. Monick suggested that the circumstances to which Chamberlain was alluding were primarily domestic. According to Chamberlain a return to gold could lead to a loss of the little reserves left or a rise in interest rates and a return to deflation.[24] According to Chamberlain such a policy would cause a business downturn and increased unemployment which could have serious consequences.

Monick pointed out that the National government had lost a lot of its popularity. Prime Minister MacDonald was unpopular and his state of health caused concern. A reshuffle would appear inevitable. However, only the forthcoming general election would clear the air. And for the time being there existed, in a sense, a political crisis. This domestic situation largely dictated the government's financial policy. And the British government would not consider policies which might jeopardise cheap money nor weaken the buoyant stock market.[25]

Monick also reported that the British government was considering a public works programme. This meant that they could not accept to be tied to gold, even if this implied a weak pound. Monick quotes Sir Frederick Leith-Ross who had told him, in confidence, that there was a stabilisation psychosis in the UK following the experience of 1925-31 and that there was no prospect that any government would stabilise ahead of the general election. According to Leith-Ross the French suffered from their own psychosis born of post-war experience. This was a psychosis of devaluation and currency instability.[26]

Leith-Ross had indicated to Monick that the only procedure which would enable an exchange of views to take place on the question of stabilisation would be through contacts between central banks. Monick ascribes this to the extreme sensitivity and unpopularity of the stabilisation issue. Such a secretive procedure would avoid the rumours which would surround any official soundings. Contacts between central banks would not bind

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[24] In a contemporary British context one could equate the policy option as that of entering the ERM, one may also draw attention to the additional similarity of an impending general election in both cases.

[25] Quoting Monick, "*Les préoccupations électorales qui apparaissent déjà ne permettent de prendre aucune décision qui mette obstacle à la politique d'argent facile poursuivie par le Gouvernement anglais. De même, rien ne doit être fait qui puisse mettre en péril le maintien des cours élevés atteints par les valeurs de Bourse.*"

[26] Monick quoted Leith-Ross, "*Il y a une psychose de la stabilisation en Angleterre, comme il y a une psychose de la dévaluation en France. Les Français ont souffert de l'instabilité du franc. Il sont opposés à tout changement apporté à leur monnaie. Les Anglais ont souffert de la stabilité de la livre entre 1925 et 1931. L'idée seule de la stabilisation les effraies. Aucun Gouvernement ne prendra le risque de stabiliser la livre avant les prochaines elections.*"

governments and such discussions could be considered preliminary soundings which might give rise to further studies and thus carry the agenda beyond the coming British elections. Monick emphasised the extent to which this limited the scope of any stabilisation initiative.

Monick also included a transcript of Chamberlain's Commons statement. This is undoubtedly that delivered on 15/5/35. Chamberlain pointed out that whereas gold had been subject to significant shifts in value, viz., purchasing power, sterling had maintained its internal purchasing power,- this view is very similar to that articulated in Roosevelt's 3rd July 1933 declaration, his so-called "bombshell". Chamberlain added that in the present circumstances it would be manifestly inconceivable that sterling should be tied to gold. Chamberlain pointed out that neither the franc nor the dollar, though on gold, had exchange rates which reflected economic realities. And that sterling found itself in an intermediate position within this equation. Furthermore, given the substantial gold reserves of both the US and France these countries played a predominant role in the functioning of the gold standard. In such circumstances if the UK were to tie itself to gold, monetary pressures coming from either of these gold centres could lead to a rapid drop in the UK's gold reserves or a rise in interest rates.

Chamberlain concluded that there was no better international currency standard than gold and that sooner or later the UK and others would return to it. But, he was not willing to envisage an early return and the UK would only return when the circumstances were right and when he was sure that he could remain on gold. This speech though less strident and confrontational than Roosevelt's "bombshell" was strikingly similar in tone.

Of particular importance amongst the documents at the Ministry of Finance is a secret telegram dated 14/3/35,[27] to the French Embassy in Washington on the recent conversations between the Ambassador, Cordell Hull and Morgenthau. These conversations had suggested that the US government would be favourable to a stabilisation agreement. The note states that in the French government's view the time was right for such an initiative. However, it stipulated that before the French government could embark on such negotiations on an official basis it needed to know President Roosevelt's views. This demonstrates the point we have already made, namely that Roosevelt's unilateral action at the London World Economic Conference had undermined the credibility of the most senior members of his administration.

[27] see: M.F., B 32 323.

Only the President's personal assurances would do, as he could so easily change his mind.

The note requests that the Ambassador meet with the President and perhaps prepare the ground, if need be, by urging a preliminary discussion between Roosevelt and one of his own advisers who might consider the French project with favour. The Ambassador was instructed to inform the President of the concern which the French government felt over the continued depreciation of the dollar and sterling and that certain Gold Bloc currencies were under strain. Continued weakening of "anglo-saxon" currencies could have the gravest economic and social consequences for the governments concerned, particularly given the already depressed state of economic activity. This note was of course sent ahead of Theunis' Paris visit at which it was widely expected that he would announce a forthcoming Belgian devaluation. This French initiative to try and secure a stabilisation accord should be seen in this context and perhaps as an attempt to forestall Belgian devaluation.

The French Ambassador was instructed to inform the President that France would be willing to support a temporary stabilisation of currencies by the central banks concerned. The French government would also be willing to consider gradual liberalisation of trade through the dismantlement of restrictions. It was argued that this would assist exchange stability. This *quid pro quo* was obviously aimed at securing the support of Cordell Hull. With the Tripartite Agreement France did, indeed, reduce many of its trade restrictions, though this was in part intended to mitigate the inflationary impact of devaluation.

The instructions note that the Ambassador should confine himself to sketching the broad outline of this plan, without going into specifics. Should this approach meet with favour then the French government would be in a position to outline its ideas in more detail. The note suggested that the procedure which should be adopted, if discussions on stabilisation were to go ahead, should be along the lines suggested by Morgenthau, i.e., a bilateral agreement between France and the US which the UK would be invited to join as soon as it was feasible. Such a solution would be better than convening an international conference, as all seem to have concurred following the disastrous 1933 World Economic Conference. If the circumstances appeared appropriate the Ambassador should also indicate that the French government would be pleased if the President himself took up the matter. The Ambassador should stress the extreme importance of secrecy to avoid rumours spreading which could undermine the Gold Bloc currencies as stabilisation was also considered a good opportunity to realign exchange rates.

As we have seen in a previous chapter French policy-makers, e.g., Germain-Martin (who was then Finance Minister), did not rule-out currency realignment as part of an overall stabilisation agreement. What they did reject was unilateral action. Mouré casts some doubt on the idea that Germain-Martin supported devaluation,[28] however it is evident that this was the case hedged by the need to do so within the confines of an international agreement. The general tone of the telegram forwarded to the French Ambassador indicates a sense of urgency,- if Theunis was to be deflected from his decision to devalue the belga there would have to be some prospect of a deal.[29] Hence, the suggestion in favour of a temporary stabilisation agreement through central bank co-operation, until a more formal accord could be reached which would settle exchange rates.

A confidential report from Appert in New York dated 12/4/35 and marked highly confidential helped to flesh out the US position.[30] It reports remarks made in confidence by an individual very close to the US Treasury who did not wish that his identity be disclosed. According to this source the initiative on the stabilisation issue should not come from the US, but France. This was because France was not only under the greatest threat, but also because it had most to lose if other currencies continued to weaken. Appert's interlocutor suggested the following basis for an agreement. France would devalue by 15-20%, this would make it easier to secure UK agreement, whilst the US would stick with its existing exchange rate. The US would promise not to further reduce the gold parity of the dollar. The UK would return to gold.

Appert stressed that these views were personal and that the government had not yet clearly formalised its monetary policy nor the objectives to be met, and that Morgenthau's conversations with the French Ambassador should be construed as an effort to engage a dialogue. The French government should let the Secretary to the Treasury know whether it intended to pursue these discussions. The French government should not press Morgenthau on specific issues relating to stabilisation on which Morgenthau did not wish to expand for domestic political reasons. Appert gathered the impression from his interlocutor that the

[28] Mouré (1991) p.240, footnote 11.

[29] Quoting this telegram, "*Vous indiquerez au Président Roosevelt que le Gouvernement français conscient de la gravité de l'heure...*" Telegram to French Ambassador in Washington dated 14/3/35, M.F., B 32 323.

[30] see: M.F., B 32 323.

object of these conversations was to demonstrate to the UK, which would be confidentially informed, that the US and France remained in close touch on monetary matters. Appert pointed out these views were consonant with those expressed by Walter Lippmann in an article which Appert had forwarded on 13/3/35. Appert's interlocutor warned that nothing might materialise from such conversations, but that the French government should grasp the opportunity whilst it lasted.

Despite the fact that this paper suggests that the US was interested in pursuing this question it is interesting to note the warning that US monetary policy was not yet clearly defined. One should also note the lack of urgency attributed to the US government in this matter. The time to stave-off Belgian devaluation had already passed and it would be the turn of the franc to gradually weaken through 1935 and then 1936, but still without an agreement being reached. One should also note the unrealistic assumption that the UK could be persuaded to return to gold. Given the reference to Lippmann's article one wonders whether Appert's interlocutor might have been Lippmann himself?

Clarke (1977) adds some detail to the discussions between de Laboulaye and Morgenthau. In April 1935 Morgenthau had suggested a cable rate of $4.85 with a margin of ten cents either side. Apparently Morgenthau suggested that if France and the US stabilised their exchanges on this basis the UK would have to act as they held 70% of the world's gold. Was Morgenthau suggesting that they should use their greater resources to force Britain's hand?[31] In March A.Hansen had prepared a paper advocating stabilisation as uncertainty was affecting the world recovery. He had suggested a franc devaluation of 20-25% and a cable rate between $4.50-4.86.[32]

However, Morgenthau's views appear to have altered rather fast. This is recorded in a note from the Ministry of Foreign Affairs to the Ministry of Finance dated 2/5/35.[33] This letter records a meeting held between the French Chargé d'Affaires, Jules Henry, accompanied by the Financial Attaché, Appert, and Secretary to the Treasury Morgenthau in Washington on 1/5/35. Henry had been instructed by the *Quai d'Orsay* to discuss

[31] Clarke (1977) p.14.

[32] Clarke (1977) p.11; see also Eichengreen Golden Fetters, pp.378-379.

[33] see: "*Le problème monétaire*," M.F., B 32 324.

stabilisation with Morgenthau.[34]

According to the record of this meeting Morgenthau expressed his belief in the usefulness of collaboration between Treasuries and central banks, but was far cooler on the question of stabilisation than he had been when he had met Ambassador de Laboulaye. The note points out that the exchange of views with de Laboulaye had taken place during a period when there had been uncertainty on foreign exchange markets.[35]

The note (drafted by de la Baume at the Commercial Relations section of the Ministry for Foreign Affairs) suggests that Morgenthau's change of tack might be because Morgenthau felt that his own personal views were not shared by the President or, having studied the matter more closely, Morgenthau had realised the difficulties attached to a policy of monetary co-operation with France. Morgenthau confined himself to stating that he was interested in an exchange of views between both governments and central banks on matters relating to monetary fluctuations, and that he was interested in avoiding sudden exchange fluctuations.

When Morgenthau was specifically asked whether he envisaged the possibility of stabilisation soon, he emphatically replied no. And that his concern was simply to establish the basis for this distant eventuality and that it would depend not only on the international, but also on the domestic economic and financial situation of the US.[36]

Henry and Appert were of the view that the reference to the domestic US economic situation said it all, i.e., everything depended on what happened to the US economy. The administration would not take a final decision on the gold parity until it had a clear picture of the results of its domestic policy. Should activity and the stock market fail to pick-up, the President would come under pressure to devalue the dollar.[37] Morgenthau gave no clues

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[34] A copy of these instructions was apparently forwarded to the French Ministry of Finance on 2/5/35 and is numbered n.1,251.

[35] Quoting this note,"*...M. Jules Henry ainsi que M. Appert ont constaté chez lui la plus grande réserve et un recul très net sur sa conversation avec M. de Laboulaye qui avait lieu à une époque de nervosité sur le marché des changes.*" see, "*Le problème monétaire,*" M.F., B 32 324, 2/5/35.

[36] Quoting this extract, "*Comme notre représentant posait nettement au Secrétaire du Trésor la question de savoir s'il envisageait la possibilité d'une stabilisation prochaine, ce dernier lui repondit très catégoriquement par la négative, il s'agissait seulement d'établir les bases d'une opération qu'il considère comme lointaine et qui dépend d'ailleurs non seulement des conditions internationales, mais également de la situation économique et financière de l'Amérique.*" M.F., ibid.

[37] Quoting from this document, "*...le Gouvernement américain ne pourra songer sérieusement à la stabilisation aussi longtemps qu'il demeurera dans l'incertitude sur les résultats de sa propre politique.*" see, M.F., ibid.

that would lead one to expect official discussions on the currency question.[38] This note suggests that either Morgenthau had originally been misinterpreted by the French Ambassador and his soundings on the French attitude were simply a search for information or his apparent change of position was because the President remained unwilling to compromise his autonomy in monetary affairs. Nonetheless, this note does indicate how far France still had to go to secure an agreement.

Monick sent a report from London on 16/5/35 which summarised the evolving debate.[39] He argued that City opinion was tending towards stabilisation, viz., fixed rates. In his introduction Monick suggests that the latest statements by Morgenthau on US policy afforded a useful opportunity to review the British position. A distinction had to be made between the City and the Treasury. In the City the recent fluctuations in the value of sterling had shifted opinion in favour of stabilisation. The City's view was that only a generalised stabilisation was likely to ensure an upturn in international trade. Domestic activity had improved, but now seemed to have reached a plateau and there was a need for revival of exports. The City no longer believed that war debts were a stumbling bloc. The US authorities were scarcely likely to upset any stabilisation by subsequently raising the issue. The City now realised that to wait until the exchange rate reflected purchasing power parity would postpone things indefinitely. In fact stabilisation would tend to favour adjustments which could not take place under conditions characterised by continually fluctuating exchange rates. Monick pointed out that the Times, which had previously favoured a managed currency, was now fully committed to a fixed/stabilised rate.

Monick warned that these views had not yet percolated into Government and Treasury circles. Neville Chamberlain still felt that a return to a fixed parity would be unpopular and the approach of a general election made him hope that an agreement could be avoided.[40] Monick argues that his opinion was bolstered by technical arguments from Treasury officials. The principal reason adduced in this context was the apparent impossibility of reaching an

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[38] Quoting the original, "*...il s'est gardé* (Morgenthau) *de rien dire qui permette d'envisager l'ouverture des conversations franco-américaines en vue de la stabilisation.*" see., M.F., ibid.

[39] "*Position actuelle de la Grande-Bretagne au sujet de la stabilisation monétaire,*" M.F., B 32 324.

[40] Quoting Monick, "*L'approche des élections générales lui fait souhaiter que tout essai d'accord monétaire, dont il craindrait la révélation dans le pays, puisse être encore écarté.*" From, "*Position actuelle de la Grande-Bretagne...,*" ibid.

agreement with the US.

Monick reports that following Morgenthau's speech and related conversations with MM. White and Sheppard he had approached Leith-Ross on a personal basis and told him that he thought that Morgenthau's apparent offer to stabilise the dollar appeared attractive. Monick asked Leith-Ross whether this could not form the basis of a US-UK agreement. Leith-Ross's view was that Morgenthau's speech had not strengthened the case for this. As long as the US imported more than half the world's gold production annually, and tried to run a balance of payments surplus no agreement seemed possible.[41]

Monick points out that Leith-Ross's stance was consonant with the tenor of the speech delivered by the Chancellor of the Exchequer on 15/5/35 (Monick states that Leith-Ross had drafted the speech). This speech would be immediately recognisable to a present-day monetarist audience. It took the line that one cannot "buck the market." It argued that one cannot fix an exchange rate without taking into account existing economic conditions. Exchange rates are the product of flows of goods and capital and it would be unrealistic to attempt to fix them unless stable economic conditions prevailed.[42]

Leith-Ross added that the British government was not without doubts as to the sincerity of the US offer. Everyone knew Roosevelt's "opportunism." He was torn between conservative elements who favoured stabilisation and an inflationary Congress which wanted him to retain the ability to devalue further should economic conditions warrant it. Roosevelt had made an offer which he knew to be unacceptable, to shift the onus for failing to act on other parties.[43] This record of Leith-Ross's views is important as it demonstrates the extent

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[41] Leith-Ross's views are echoed in Drummond (1981). The U.S., "...deliberately depreciated its currency against gold, thus winning an advantage in world trade even though its balance of payments was already in surplus on current account and even though it had virtually ceased to lend abroad"... "When we are told that the 1930s was a decade of competitive devaluation, in large part we are hearing an echo of American economists' guilt: it was their country, not Britain, that deliberately destabilized the set of exchange rates." p.257.

[42] Quoting this extract in the French translation, "*Les cours des changes s'établissent comme une résultante des mouvements de marchandises et de capitaux, et, de même qu'il est vain de mettre un navire à l'ancre sur des sables mouvants, de même c'est une entreprise futile de vouloir réaliser la stabilisation monétaire aussi longtemps qu'on ne peut raisonnablement prévoir une certaine stabilité des conditions économiques après la stabilisation faite.*"

[43] Quoting Monick's report on Leith-Ross's comments, "*Mr. Roosevelt, dont nous connaissons l'opportunisme,*" *m'a dit Sir Frederick,* "*est pressé par les éléments conservateurs de stabiliser définitivement le dollar. Mais d'un autre côté, les éléments* "*inflationnistes*" *du Congrès veulent qu'il se garde les mains libres en vue d'une nouvelle dépréciation de la monnaie si les circonstances économiques le nécessitaient. Hésitant*

to which Roosevelt was mistrusted by both British and French policy-makers and the additional hurdles which this placed in trying to negotiate a stabilisation agreement.

Monick found it difficult to accept Leith-Ross's view and felt that Roosevelt's approach was sincere. He added that US opinion wished to be rid of monetary uncertainty in order to stimulate trade and raise prices. This desire for greater certainty explained Roosevelt's offer. In this respect Monick appears to have been too credulous.

Monick suggests that Morgenthau's speech had not been given proper consideration by British policy-makers. He points out that it came at a time when the UK was particularly worried about the world monetary situation. Leith-Ross indicated (in strictest confidence) that the Treasury was receiving alarming information every day about the general European financial situation. Monick felt that financial relations between the US and UK were becoming more tense by the day. The US exchange equalisation account was determined to maintain (provisionally and until conversations on stabilisation could begin) sterling at $4.86, by purchases of gold, silver and sterling balances. Monick argued that if Morgenthau's offer were not taken up relations could only deteriorate.[44]

Monick pointed out that the UK government was apprehensive about the situation which reminded him in many ways of the situation preceding the crisis of summer 1931. Monick concluded though that US stabilisation might still have some chance of success. Roosevelt would have to make it known that, though the US government would maintain the parity of $4.86, should a more cordial atmosphere develop in which agreement could be reached, the US would be willing to let sterling find a new level somewhat below the present parity. Again one gets the impression that Monick was being rather too optimistic.

Monick drafted a second note, dated 17/5/35, recording a meeting with two US Treasury officials, MM. H.D.White and Sheppard. It notes that the meeting took place at their request.[45] The object was to flesh out Morgenthau's recent speech. According to the

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entre les deux partis, le Président Roosevelt fait à l'Angleterre une proposition de stabilisation qu'il pense inacceptable. Il rejette ainsi sur l'étranger la responsabilité de son inaction." see, Monick, ibid.

[44] Quoting Monick, "*Entre l'Angleterre et les Etats-Unis, les relations financières deviennent chaque jour plus tendues. Le fond des changes américain ne cache plus sa volonté de maintenir provisoirement et jusqu'à ce que des conversations soient entreprises sur la stabilisation, la livre sterling à la parité de $4.86, en achetant de l'or, de l'argent et en absorbant sur le marché toutes les devises anglaises qui sont offertes.*" ibid.

[45] see: "*Interprétation du Discours du Secrétaire d'Etat américain, Mr. Morgenthau sur la position monétaire des Etats-Unis,*" M.F..

US experts, London had underestimated its importance. White brought the following clarifications, viz., that Morgenthau's speech implied that the President would not make further use of his authority to devalue the dollar. The US administration would even be willing to relinquish its authority to devalue the dollar if an international stabilisation agreement could be reached. White added that Morgenthau had made clear what would be the basis of agreement, namely the existing gold parity of the dollar. We know from Monick's conversations the previous day with Leith-Ross that the British were not happy with the current dollar/sterling exchange rate. Monick felt that the US was proposing a stabilisation agreement because domestic activity would not pick-up until confidence had been restored as a result of such an agreement.

According to Monick the US realised that stabilisation would involve a devaluation on the part of the Gold Bloc and that this would eliminate one of the most significant deflationary forces acting on world prices, i.e., the over-valuation of the Gold Bloc currencies. However, as the Gold Bloc members states were price-takers the only deflationary impact which over-valuation of these currencies could have on world prices would be demand-induced due to the deflationary policies adopted by these states in order to maintain exchange parities (because prices were too high!). The US as a price leader and dominant world trading nation was far more directly responsible for deflation through exchange dumping, i.e., devaluation,[46] and the collapse of the US price level.[47]

Monick argued that an orderly and managed devaluation of Gold Bloc currencies would be preferable to serial devaluations of these currencies, as the uncertainty generated by the latter eventuality might give rise to excessive devaluations.

Monick reported that if France chose to devalue by 20% the US would not consider

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[46] Quoting Drummond (1981), "We are often told that in the 1930s there was a great deal of "competitive devaluation." The literature suggests that country after country depreciated its currency so as to win a competitive advantage. It is never clear, however, which countries are supposed to have done this evil thing. Clearly neither Britain nor the Empire countries did so. Devaluations, when they occurred were imposed by market forces." p.256. This is a view shared largely by Professor S.Strange and with which I wholly concur. In fact it might be argued that this view was propounded by the likes of Cordell Hull in order to secure a post Second World War liberal free trade system which would be as much in the US's economic and political interests as free trade had been in the UK'S during the nineteenth-century. It may also be argued that this policy was aimed at avoiding the erection of currency blocs so that the US could reap the benefits derived from having a hegemonial currency, financial and trade status. This area also fell under the umbrella of the US security guarantee.

[47] Whether caused by real or monetary factors, cf., Temin; Kindleberger; Friedman; Eichengreen Golden Fetters; Eichengreen also recognises beggar-thy-neighbour effects resulting from currency depreciation.

it an aggressive act, as it would be conducive to economic recovery in the countries concerned. If as a result of Gold Bloc devaluation, sterling were to weaken, the US would not consider an exchange rate in the region of $4.60-4.50 as tantamount to competitive depreciation. If the UK exchange equalisation account had insufficient resources to support sterling at the old parity of $4.86 the US would not consider its old parity as a *sine qua non* for conducting discussions on stabilisation. Clarke (1977) records that in May 1935 Monick informed Sir Frederick Phillips of these suggested parities and that the US no longer considered the old parity of $4.86 as essential.[48] According to Clarke, Phillips was interested. Phillips was encouraged by Sir Warren Fisher (Permanent Secretary to the Treasury 1919-1939) to pursue the matter, particularly as the British government had been perhaps too reticent towards recent US overtures. Fisher suggested that a stabilisation agreement might make it easier for Roosevelt to, "resist the clamour of the inflationists."[49] However, nothing came of this. Clarke ascribes this to Neville Chamberlain's refusal.

Monick reported that the US had not proposed convening an international conference, though it did not wish to prejudge the issue on the basis of past experience. However, they were going against the grain of received of opinion, namely that the World Economic Conference of 1933 was an experience which ought not be repeated. The view of the US source was that although states had acted unilaterally, this did not necessarily mean that an international agreement could not be reached. For the time being the US thought that discreet discussions between central banks and treasuries would be the best ground work for such an agreement. Monick's US interlocutors thought that it would not be a good idea if the UK, the US and France arrived at an agreement on their own as countries outside it, in particular Germany, would take the opportunity to unilaterally devalue against the stabilised currencies. The latter caveat is rather astonishing. It mattered little what Germany did in 1935 as its trade was effectively carried out under a barter currency regime in which free exchange rates had no part to play.[50] As for the other states, they were relatively insignificant. Eichengreen cites Morgenthau on 20th June as emphatically opposed to another

[48] Clarke (1977). p.19.

[49] Clarke (1977) p.19.

[50] see Hirschman (1945).

world monetary conference.[51]

Monick finally pointed out that these discussions should not be confined to exchange rates, but should also aim at improving the working of the gold standard through central bank co-operation and if needs be a commitment on the part of these institutions to closely follow a new set of "rules of the game."[52] The negotiations should also prepare the way for a general reduction in customs barriers, abolition of quotas and a progressive dismantling of clearing agreements and other restrictive trade practices.

In the last note I found at the Ministry of Finance, Appert summarises the views put to him by US State Department and Treasury officials. It is dated 13/6/35 and assesses whether the recent weakness of the franc had encouraged the US authorities in favour of an agreement.[53] Appert also alludes to increased confidence in France as a result of measures adopted by the French parliament (Laval had just become Prime Minister with decree-making authority) and whether this might not conduce to a favourable climate for stabilisation. However, the Americans indicated that though they might wish to help France the attitude of the UK precluded this. Appert felt that the UK would not be willing to fix exchange rates ahead of a general election, and this had been confirmed to him by the UK Financial Attaché in Washington.[54]

According to Appert's report US officials did not believe that Morgenthau would undertake another initiative on this issue. It did not seem that the British were willing to enter into discussions and any new US initiative would have to wait till circumstances changed. One of Appert's interlocutors remarked that a stabilisation policy would not in any case have enough support amongst the public which had become more concerned with domestic policy issues than monetary affairs. Appert concludes by noting that opinion in

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[51] Golden Fetters, p.378.

[52] Quoting Monick, "*Elles auraient également pour objet la recherche des méthodes propres à assurer un meilleur fonctionnement du gold standard par une coopération étroite entre les banques centrales, impliquant au besoin l'obligation reconnue par les différents instituts d'émission de respecter les règles à nouveau édictées du mécanisme de l'étalon or.*" ibid.

[53] see: M.F., B 32 324.

[54] Quoting Appert's note, "*Il leur semble impossible, et ceci m'a été confirmé par l'Attaché financier anglais que le Gouvernement britannique, plus soucieux que jamais de ne pas heurter l'opinion intérieure, modifie son point de vue sur la question avant les élections générales qui ne peuvent avoir lieu avant l'automne.*" see: M.F., B 32 324, 13/6/35.

Washington was that there was little prospect of stabilisation, even if provisional, in the coming months. Though these discussions appear to heap a lot of the blame on the UK it is clear just from this exchange of views how fickle american opinion might be, viz., whilst making noises in favour of stabilisation and blaming the UK for obstruction it would be added that in any case US public opinion would not favour such a policy. With this in mind one cannot but recall Leith-Ross's initial misgivings.

Two further papers are of particular note, before we move on to the actual Tripartite Agreement, as they examine the policy alternatives to a liberal economic solution. The first of these papers examined the conditions under which trade could be revived within the parameters set by the over-valued exchange rates prevailing within the Gold Bloc. The second is a report on the conditions needed to enforce a strict regime of exchange controls. The latter paper was prepared on 11/6/36, just as the Popular Front was coming into office. The severity of the measures it outlined are so demanding that one wonders whether it was not actually drafted to dissuade the authorities from adopting such a policy,- which the French political establishment had long opposed.[55]

The first of these policy papers was drafted on 23/5/35.[56] The paper argues that a necessary condition of French economic revival was an increase in foreign trade as measures which could be taken at a national level were necessarily limited. This stance is typical of much of the reasoning of the period, and too little attention was paid to the perverse effects of deflationary aggregate demand policies imposed by the arbitrarily fixed exchange parity. The paper argues that in order to establish the conditions for trade revival a stable framework was necessary. To put this into effect France would be willing to collaborate within a grouping of countries which shared a similar economic and social system and whose currency had been stable for the past six months. These countries would have to agree to maintain the parity of their currencies, not to impose payments restrictions, and to abolish all indirect trade restrictions (we would now refer to them as "non-tariff barriers", NTBs). Tariff schedules could be revised to take this into account. States party to the agreement would agree to negotiate reciprocal tariff concessions. Until such a framework could be put into place France would acknowledge the use of quotas,- hardly surprising as France had a raft

[55] see chapter seven of this thesis.

[56] see: M.F.,B 32 323.

of quota restrictions in place, particularly to protect its agricultural sector.

France would distinguish between two groups of countries, those which refrained from using measures which restricted trade, e.g., quotas, clearing agreements, exchange controls, etc., and those which did not. Towards the former France would loosen its quota restrictions as far as possible.[57] Quota allocations could be increased by transferring part of the quota allocations of countries which did not subscribe to these principles. Extra quota allocations could be created, over and above the existing allocations. These would be subject to an intermediate tariff which would be set to become the permanent tariff once quota restrictions had been dismantled (one might add cynically if the measures outlined above had not led to a trade war before). The paper suggests that this partial liberalisation would allow economic agents to get a foretaste of the conditions which would eventually prevail amongst countries party to the agreement. However, quotas would continue to be strictly maintained against countries not party to the accord and the paper even proposes that new restrictions could be imposed if concessions offered to France were insufficient, or if payments difficulties forced France to reduce her trade with the country concerned.

The paper concludes that France's trade policy should comprise the following criteria: abandon of the policy of the most-favoured-nation clause applied to quotas. France should manage its quotas and make quota allocations secret! As we have seen in chapter six France had urged Gold Bloc member states at the Bruxelles Conference, held in October 1934, to ask for a derogation from MFN affecting quotas. This had been rejected by other member states. Of course, quotas are discriminatory by nature and as such are incompatible with MFN. France would offer quota concessions to countries which were willing to extend to France similar advantages. These states would ensure that commercial payments were settled; refrain from resort to un-natural commercial practices; practise stable economic, social, and monetary conditions.

The concessions offered would be the following: removal of quota concessions where possible to be replaced by tariffication; an increase of quotas within the overall quota limits; and creation of an intermediate tariff under which additional quotas would be awarded within a percentage ceiling of the total existing quota. Other initiatives which would be studied might include increasing export credit guarantees and measures to unblock uncleared funds.

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[57] "*...le contingent serait assoupli dans toute la mesure du possible.*" source: M.F., 23/5/35, B 32 323.

This note belongs perhaps more properly in our section on the Gold Bloc (and in particular the note drafted on 15/3/35 ahead of Theunis's Paris visit on 15/3/35), nevertheless it does provide a pointed contrast to the more liberal solutions which supporters of stabilisation would have wished for, e.g., Reynaud and, it would appear, Cordell Hull in the US.

The second note of considerable interest is the paper drafted on 11/6/36 on measures to be taken in order to implement exchange controls.[58] This paper suggests that the incoming Popular Front government (4/6/36) might have considered imposing exchange controls. The paper which details measures needed to implement exchange controls is so drastic in its recommendations and pessimistic about the ability of the authorities to devise a watertight system that one cannot but wonder whether it was not drafted with the intent of dissuading the authorities from adopting such a policy.

The note begins by stating that it is based on Germany's experience with exchange controls since July 1931, surely an extreme example. The paper argues that a system of exchange controls must be foolproof or any loophole would act as a bolt-hole for flight capital. It also suggests that specialists would find ways of circumventing the measures and that these measures would have to be draconian and authoritarian. Mouré quotes Bouvier who suggested that exchange controls were considered a technical measure and not part of a militarised economy as in Germany.[59] However, this does not seem to have been the case. One should recall that Blum partly rejected the exchange control option for foreign policy reasons, as it would cut France off from the democracies.[60] This was already a socialist government acting with communist support. Capital controls might have further widened the gulf with the democracies. Blum was well aware of this contradiction between his domestic policy goals and foreign policy.[61] According to Mouré, Monick, and Baumgartner (*Inspecteur des Finances*; Treasury Mandarin; Governor of the Bank of France

[58] see: "*Aperçu des mesures à prendre pour contrôler la sortie des capitaux*," M.F., B 32 324.

[59] Mouré (1991) p.238, footnote 3.

[60] see chapter seven of this thesis.

[61] Lefranc (1974) quotes Blum's statement to the Chamber of Deputies on 26/2/36, "*La pente logique de notre politique intérieure nous conduirait vis-à-vis de l'exportation des capitaux et de la spéculation à des mesures coercitives...Mais il y aurait contradiction avec notre politique qui recherche une communauté d'action avec les grandes nations anglo-saxonnes et la signature d'un accord monétaire qui tend à rendre l'activité et la liberté aux échanges internationaux.*"

1949-60) emphasised that exchange controls were a fascist alternative and stressed the foreign policy aspect of adopting measures which were "*solidaire*" of the anglo-saxons.[62]

The paper outlines the various measures which would be needed to maintain exchange controls, viz., prohibit the export of: Bank of France notes; gold; precious metals; gems; jewellery; etc...; all claims held on foreign entities or centres, e.g., bank notes, bonds, shares, commercial paper, etc...; French bonds, cheques, commercial paper drawn on France, etc.; import without making a declaration: French and foreign bank notes, bonds, etc.; all payments in France to foreigners or to a French man on account of a foreigner; and request the repatriation of all capital held abroad.

The paper goes on to argue that in order to enforce these measures they would have to apply to all French residents. Payments abroad would have to be vetted by a special office. Enforcement would mean postal censorship and physical control of all persons entering or leaving the country. All parcels and vehicles would have to be checked. The controls would have to check that all goods paid for were actually imported; the prices of goods imported and exported would have to be checked to avoid transfer pricing; the control would have to check that no clandestine exports were made.

These controls would put an end to capital inflows as economic agents would prefer to risk incurring penalties rather than declare their assets, as experience had demonstrated. Certainly the period before the Poincaré stabilisation when there existed capital export restrictions had not been successful. To be effective the controls would probably have to involve the seizure of assets held abroad. The paper remarks that these measures would require a significant increase in the resources of the customs service, a doubling or so. All goods would have to be accompanied by a declaration of their value, which would have to be forwarded to the central exchange office so that it could ensure that the balances were repatriated (to avoid leads and lags). Chambers of Commerce could not be relied upon to do this and offices in each French *département* would have to be created to do this. Activities of banks would also have to be monitored. A central office in Paris would have to be created to take overall control.

The author of the paper argues that these measures would require a great deal of administrative work and expense, 10,000 or so new jobs would have to be created. And

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[62] Mouré (1991) pp.242-243.

whatever the success of the measures the extra costs which these measures would impose on exporters would dissuade them and would result in a drop in exports. Draconian penalties would also have to be introduced to act as a deterrent. And because of the need to train employees of this new administrative service it would take at least a year before an effective system could be put into place. Even then economic agents could be relied upon to find ways around the restrictions.[63]

Though France did not have a successful record with capital controls (and had in fact in the 1920s backed off introducing radical measures such as mail censorship under Herriot's premiership), one cannot escape the impression that this paper was drafted by someone virulently opposed to exchange controls.

Were the negotiations aimed at securing a stabilisation agreement continued under the Popular Front? What was their character? We now know from Vincent Auriol's own confession that the Popular Front government had realised that they would have to devalue, though it was deliberately excluded from their electoral platform at the behest of the communists. Blum had been more favourably inclined towards devaluation in 1934.[64] Did the Tripartite accord only materialise when a forced French devaluation was about to become a *fait accompli?*

THE TRIPARTITE AGREEMENT:

Clarke (1977) has chronicled stabilisation efforts as the Popular Front was coming to power. His study indicates that Morgenthau had become convinced that the French would have to devalue given the level of gold losses that had been sustained over the previous uncertain months. Clarke gives the following figures for gold losses, in April they were $242 million and in May $326 million. The Popular Front had won the election at the end of April, but did not form a government till 6th June. During this period the wave of sit-ins strikes had begun. Eichengreen alludes to rumours towards end-March/April that a gold embargo might

[63] In this paper the author gives an example of a method used to get around German capital export controls. This involved the purchase of a Dutch security in Germany which would be promptly destroyed before a witness. A sworn statement recording this would be drawn up. In Holland this affidavit could then be used to acquire duplicate securities. Source: "*Aperçu des mesures à...*", M.F., B 32 324, 11/6/36.

[64] see chapter seven of this thesis.

be introduced,[65] this would certainly have exacerbated the capital outflow. He also mentions that the Bank of France lost 20% of its gold reserves in March 1936 and on the 28th the discount rate was raised from 3.5% to 5%.

Morgenthau proposed that the US should inform the French authorities that if they were to devalue within a margin of 20-30% the US would not retaliate. Auriol appears to have been shocked by this direct approach just as he was coming into office. Auriol stated that he could not take the initiative or he would have to resign and that it would have to come from the US. He added that the agreement would have to be negotiated with other Gold Bloc states and that it should be sold as a measure to bring currencies in alignment with world prices. However, the last proviso was certain to jeopardise the agreement. This was that, "Exchange rates established under the arrangement could not be altered subsequently except with the consent of the other parties."[66] Clearly this would never be acceptable to the British government. Neville Chamberlain refused to approach the French on the matter, on the grounds that he did not want to be seen to be pushing the French towards devaluation.

However, Morgenthau pursued his initiative instructing Cochran, First Secretary to the American embassy in Paris,[67] to approach the Swiss and the Dutch at the forthcoming meeting of central bankers at Basle. Apparently both showed interest in an arrangement which would allow them to devalue 20-25%. And the British indicated that they would find a margin of devaluation for the French franc of 15-20% acceptable, with a 25% maximum. Bewley (the British representative) added the important caveat that the British government could not commit itself to exchange rate stability.

Clarke argues that this initiative failed partly because Blum was intent on reaching his own agreement and had dispatched Monick to discuss the matter with Roosevelt on 6th June. Apparently Auriol was only informed as Monick was sailing to the US,- which seems rather an odd procedure to adopt towards one's newly appointed Finance Minister. On the same day Blum made his commitment in parliament, that France would not wake up one day to find the franc devalued. However, Baumgartner subsequently stated that, "Léon Blum decided upon devaluation in the first fortnight of his government" and, "Georges Monnet was

[65] Golden Fetters, p.373.

[66] Clarke (1977) p.25.

[67] cf., Mouré (1991).

sent to Washington to clear the ground and London was probably informed in the middle of August."[68]

As we will see in chapter nine Monnet was used as an emissary by Morgenthau in late October 1938. He carried proposals which encouraged the Daladier government to introduce exchange controls.[69] But, he arrived after Marchandeau's dismissal as Finance Minister and his successor, Reynaud, opted for a liberal economic course. Mouré has argued that the Popular Front's negotiations were rather haphazard and that the government dithered,[70] toying with the idea of exchange controls (in August 1936 with measures directed at so-called speculators), and then devaluation when forced to do so. One must however emphasize the heterogeneous nature of the coalition Blum led which constrained his actions.[71]

Monick rested his case for devaluation on the need for economic revival and rearmament. Monick suggested a devaluation within margins of 25-28%. This yielded a fluctuation band of 4.5% and at its mid-point the franc would trade at FRF 20.6 to the dollar and FRF 100 to the pound. Mouré mentions a band of fluctuation of $\pm$ 2.5%.[72] A band would allow the French authorities to regain some autonomy in the sterling/franc rate which the British Exchange Equalisation Account could heretofore manage because of the fixed gold price of the franc. He suggested that the British commit themselves to a cable rate of $4.75-4.97 to constrain the fluctuations of sterling.[73]

Clarke argues that the French did not press the initiative urgently as the franc was strengthening and gold flows were reversed. Auriol's confident statements in support of the franc (jawboning) made on 15th July appeared to have worked. July recorded an increase of $63 million in gold reserves. Bank rate was reduced from the high of 6%, which it had reached before the formation of the Popular Front government. It now stood at 3%. However, Monick did pursue these discussions with his British counter-parts in July. The

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[68] Kemp (1972), pp.112 & 119.

[69] see Drummond (1979).

[70] Mouré (1991) p.245.

[71] see chapter one of this thesis.

[72] Mouré (1991) p.250.

[73] Clarke's source is Monick's, Pour Mémoire, published in 1970.

British would not give any assurances on exchange stability. Monick had been suggesting bands of 2.25%. Nevertheless, Neville Chamberlain agreed to a draft letter (which was to remain unsigned until the French authorities were ready to devalue) which indicated that the British government would acquiesce to a devaluation of no more than 100 francs to the pound. Clarke records a last round of discussions between Bewley, for the British government, and Morgenthau on stabilisation of the cable. Morgenthau suggested a margin of $5.00-4.90, a margin of fluctuation of, "slightly more than 2 per cent, compared with the 4.5 per cent suggested by Monick as appropriate for the interim period."[74] This was unacceptable and apparently Bewley concluded that it was impossible to co-operate with Morgenthau. Drummond (1979) also forms a very poor opinion of Morgenthau.

Clarke dates these discussions to 22nd July. The August holiday postponed further discussions till September. It is possible that the Blum government lost an opportunity, although it would have had to accept that the British government would refuse any firm exchange rate commitments. Mouré argues that Auriol still entertained unrealistic assumptions about what could be achieved,[75] i.e., a pre-stabilisation accord followed by a definitive currency agreement. Given the wave of strikes which had just come to an end in France and the government's economic policy programme it is by no means clear that devaluation would have brought early relief to the government. It could have sparked renewed strikes in favour of compensatory wage claims. Certainly the communists who formed a constituent part of the Popular Front opposed devaluation and the radical-socialists who were in government would not have been too happy either.

The discussions were renewed in September. Clarke (1977) dates the beginning of these discussions to the 4th. Official documents at the Ministry of Finance record the process of finding suitable language as a basis for a Tripartite Agreement immediately prior to the French devaluation of September 1936. Mouré argues that as a result of the significant gold losses the Treasury concluded in favour of devaluation, "in the first days of September."[76] The French authorities presented a draft agreement to the US and UK which elicited certain amendments, notably the exclusion of any reference to a gold-based financial

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[74] Clarke (1977) p.32.

[75] Mouré (1991) p.254.

[76] Mouré (1991) p.256.

system as the ultimate goal. The French document is dated 8/9/36.[77] It begins by stating that France had always rejected unilateral devaluation, which was but an instrument of economic warfare likely to provoke retaliation. On the contrary, France wished for economic and monetary disarmament and hoped the agreement would stop autarkic tendencies.

The document argues that with this aim in mind, and to cure the disequilibria caused by falling prices and devaluations, France should propose a provisional stabilisation agreement (*un accord de préstabilisation*). Such an agreement would establish new exchange rates which would take into account world prices. The agreement would have to be maintained by means of close collaboration and could only be modified by a collective agreement unless exceptional circumstances should intrude. However, the ultimate goal of the parties to the agreement would be a return to the international gold standard when conditions were ripe,[78] as evidenced by the prefix pre-(stabilisation) to the French proposal. This condition would prove unacceptable to the British.

Finally the paper suggested that such an agreement by reducing existing disequilibria would make it possible to reduce trade barriers. The paper ends with a liberal idealist note suggesting that such measures would tend to restore trade and contribute to mitigate the threat of war. The offer to liberalise trade was obviously intended as a *quid pro quo*, but would also reduce imported inflation. A draft of the proposed declaration is included in Appendix.[79]

The US response to the French paper is dated 10/9/36.[80] Cochran states that he

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[77] see: "*Projet de note au gouvernements américain et britannique*," M.F., B 32 325, a manuscript note at the top indicates that the paper had been handed to MM. Cochran and Monick on 8/9/36.

[78] Quoting this draft paper, "*...l'objectif final des contractants devant être le retour général à l'étalon or international quand les conditions nécessaires se trouveront réalisées.*" Source: "*Projet de note aux gouvernements...*" *vide supra*, M.F., B 32 325.

[79] French draft of a Tripartite stabilisation agreement (see, M.F., "*Projet d'accord de préstabilisation*," M.F., B 32 325), "*Les Hautes Parties contractantes décident de faire tous leurs efforts et d'établir entre elles la plus étroite collaboration en vue de maintenir les chances* (sic., (!) should read "*changes*") *de leurs devises respectives entre les limites fixées dans le tableau ci-joint. Ces limites ne devront être modifiées que d'un commun accord ou, sous réserve d'en aviser les cocontractants, en cas de circonstances exceptionnelles et imprévues, l'objectif final des cocontractants étant le retour général à l'étalon-or international quand les conditions nécessaires se trouveront réalisées.*"

[80] see: M.F., B 32 325, a manuscript note indicates that this was the reply delivered by Mr. Cochran.

understood the circumstances which had brought about the French initiative and the desire to secure more stable exchange rates and an increase in international trade. Cochran ventured that increased stability would eliminate destabilising capital flows, and that capital flows should be regulated by economic circumstances. However, Cochran expressed the opinion that the text as drafted made commitments which were not necessary, this applied particularly to the second paragraph. This is the paragraph in which mention is made of the gold standard.

Cochran then went on to state what had been the basis of US policy, namely to maintain the exchange parity of the dollar. Cochran added that this had been the British government's policy too. In the circumstances should the French government choose to devalue for domestic reasons by an acceptable rate, the US authorities would do everything in their power to maintain the dollar exchange rate at its current level and would hope that the British authorities would do likewise.

Cochran's note ends by stating that he hoped the French authorities would understand that in the final analysis the exchange rate would have to be determined by the internal price level and domestic economic conditions. Cochran suggested that a statement along these lines would elicit the support of both US and UK governments and that declarations could be issued jointly by all three governments. Cochran suggested that the respective treasuries could discuss measures aimed at implementing the agreement.

What is immediately apparent from Cochran's note is that the US government was not willing to tie its hands on the issue of the exchange rate. Such a commitment had been implied in the French draft which suggested that exchange parities only be altered by common consent. Cochran made no mention of the gold standard, though the US dollar was now pegged on gold. This was undoubtedly partly to pander to British reluctance on this issue, but also reflected US domestic exigencies.

The note from the British Chancellor of the Exchequer was more reticent than that submitted by Cochran. The Chancellor made it clear that the British government was unwilling to undertake binding commitments on its exchange rate policy. His letter made no mention of a return to the gold standard.[81] The Chancellor noted that the tenor of the French draft was at odds with the position which he had adopted in the July discussions. The

[81] see: letter from the Chancellor of the Exchequer dated 14/9/36, M.F., B 32 325.

Chancellor was not willing to surrender any independence of action and his decisions in the monetary field would continue to be guided by UK domestic credit conditions and the international situation.[82] Nevertheless, the Chancellor added that the UK would avoid disrupting the foreign exchange market. The relative stability of sterling over the past two years attested to these good intentions. He expressed the view that if monetary policy were guided by maintenance of the greatest possible exchange stability and the careful assessment of the impact of any changes in monetary policy on other countries, this would provide a more useful basis than any solemn commitments. Apparently the Chancellor's letter of July had been drafted with these conditions in mind. The Chancellor rejected the idea of engaging in lengthy technical studies. He concluded by expressing the hope that the co-operation which existed between the Bank of France and the Bank of England would be maintained, whatever the French government's decision. This letter makes it quite clear that the British government was willing to acquiesce in French devaluation, but was unwilling to enter into commitments which might reduce its autonomy.

Clarke (1977) confirms that the US was keen on stabilising sterling around the existing $5.00. Clarke's study makes it clear that the French had not understood that the UK would not relinquish its monetary independence. And Roosevelt strongly objected to the original French draft with its reference to gold. The British would have preferred France to return to a fixed parity against gold, but France preferred to allow some lee-way to manage the sterling/franc exchange rate, and as the UK did not maintain a fixed parity it did not feel able to press the point. However, for intervention purposes they would negotiate an exchange guarantee agreement.

Ahead of the French devaluation and the joint publication of the Tripartite Agreement the Bank of England and the Bank of France reached a tentative technical agreement on exchange intervention.[83] It was agreed in principle, until properly endorsed by the competent authorities, that the Bank of France and the Bank of England would establish

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[82] Quoting the French version of the document, "*...il n'est pas prêt (le Chancelier), dans les conditions qui prévalent actuellement, à limiter son pouvoir d'action indépendante par un accord solennel tel que celui qui lui est proposé aujourd'hui. Dans les engagements qu'il donne le Chancelier en effet doit être dirigé non seulement par les considérations sérieuses auxquelles le Gouvernement français a fait allusion, mais encore par l'étude qu'il doit faire de temps en temps des besoins de crédit de l'économie anglaise aussi bien que par la situation internationale.*" Source: letter from the Chancellor of the Exchequer, M.F., B 32 325, 14/9/36.

[83] see: "*Protocole de la conversation tenue par le Représentant de la Banque d'Angleterre et celui du Service Bancaire Etranger de la Banque de France,*" B 32 325.

every morning the rate at which they would sell gold to one another. The price of gold in London would be determined by the exchange rate between sterling and the dollar and the dollar price of gold in New York, minus theoretical shipping costs from the US. The same method would be employed to calculate the price of gold in Paris. The price could be altered during the day, but all transactions booked before the new rate was set would be transacted at the old rate. Any foreign exchange transactions conducted by the Bank of France on its own account, outside the agreement, would fall outside this regime.

The record notes that there was a slight disagreement as to the sterling/franc cross rate. The then prevailing cable parity of $4.95, yielded an exchange cross rate against the franc of 106.2541 (at a gold parity for the franc set at 46milligrams at 9/10th fine,- the mid-point between the new maximum gold weight of the franc set at 49mg. and its minimum parity of 43mg.). Apparently the London authorities would have preferred a cross rate of 103 francs which would then be allowed to rise to 105 francs. However, the French pointed out that for psychological reasons they would prefer the reverse to occur, viz., a slight appreciation of the franc against sterling. The note concluded though that it would be impossible to set an exchange rate until it was known whether the US Treasury would deliver gold against dollars held at the Bank of France.

The French Tripartite declaration, a copy of which at the Finance Ministry is dated 25/9/36 and approved by the Council of Ministers,[84] clearly marks a compromise on the earlier French draft as it does not contain any firm commitment to return to gold. The text declares that the new gold value of the franc would be between 49mg. and 43mg. of gold at 9/10th fine. And that a stabilisation account with 10bn. French francs at it disposal would be created to manage the exchange rate. The stabilisation funds were to be secured on the profits realised from a revaluation of the Bank of France's gold holdings. The precedent for establishing a gold or exchange parity within a band was set by the US administration which retained the faculty to devalue the dollar to 50% of its previous parity or a further 9% against its old gold parity.

The French declaration[85] stipulated that until the bill had been adopted by parliament the Bank of France would take measures to stem speculation. Stock and commercial

[84] see: M.F., B 32 325.

[85] see Appendix of this thesis.

exchanges would also be closed. In fact the Paris stock exchange was closed for a whole week. The declaration goes on to state that this policy which was agreed with the UK and US aimed at restoring peace and prosperity in international relations.

Paragraph two of the French declaration is very significant, as it indicates the extent to which the French authorities had to compromise. The French government recognised that the main consideration determining British and US exchange rate policy would remain the internal prosperity of the US and the British Empire.[86] If one recalls that the earlier French draft had called for a firm commitment to fixed parities and an eventual return to gold, one can appreciate the degree to which they had compromised. Paragraph two went on to provide reassurance that the UK and US governments would continue to pursue the policies of the last few years which aimed at maintaining the greatest possible stability in exchange markets.

Paragraph three stated that it was the view of the French government that stable currency relationships could only be achieved if a new equilibrium were established, and to this end it would propose a devaluation of the French franc to parliament. This paragraph records the approval of the US and British governments. It adds that all three states had resolved to use any appropriate measures to ensure that the new exchange parities would not be undermined. This obviously aimed at increasing the cost/risk of speculators testing the new market parities by threatening intervention. However, the fact that the franc's new parity was set at its upper limit, and the Bank of France's gold reserves had been revalued on that basis, rather than allowed to fluctuate between its maximum and minimum parities, would soon make the speculative process something of a one way bet, viz., that the franc could only fall.

Paragraph four stated that the French, British and US governments agreed that the success of this policy was linked to an increase in world trade. To this effect they attached the greatest importance to prompt action to gradually remove, and finally abolish, both quotas and exchange controls.

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[86] Quoting from this declaration, "*Le Gouvernement des Etats-Unis d'Amérique et le Gouvernement de la Grande-Bretagne doivent naturellement dans la politique monétaire internationale tenir pleinement compte des exigences de la prospérité intérieure de la République Américaine et de l'Empire Britannique, de même que le Gouvernement français tiendra naturellement compte de considérations analogues en ce qui concerne l'économie de la Métropole et des possessions d'Outre-Mer.*" Source: French Tripartite Declaration, M.F., 2?/9/36, B 32 325.

Paragraph five stated that the governments concerned hoped that third parties would co-operate and not try to undermine the agreement by seeking unreasonably competitive exchange rates, i.e., the agreement opened the way for devaluation of the other Gold Bloc currencies.[87]

What is clear from the foregoing is that France had failed to realise its original aim of securing an agreement which would encompass some commitment to fixed exchange parities. As Drummond (1979) has pointed out the Tripartite neither mentioned specific exchange rates, nor promised a return to gold or fixed parities over the longer term. The Tripartite Agreement, somewhat a misnomer as each government issued its own statement, was but a recognition on the part of the UK and US governments of France's devaluation and a pledge not to engage in competitive devaluation. France failed to secure some form of exchange rate commitment and ultimate return to the gold standard as a final objective of international monetary policy (which had been its policy objective since the 1933 World Economic Conference).

In a note from Appert, dated 7/10/36,[88] it is clear that Roosevelt's monetary policy stance had changed little. Appert reports Roosevelt's latest pledge, that if he were re-elected he would seek to have his authority to devalue the dollar to 50% of its former gold parity renewed. And that this authority would be necessary as the President's primary objective remained the protection of the internal price level. Such a margin was also necessary in case monetary action by a foreign government should impact on the domestic US price level. The only area likely to have a significant impact was the British Empire. This statement though understandable from a domestic perspective was nevertheless unhelpful coming so shortly after the Tripartite Agreement and demonstrated that little had really changed. Appert points out, though, that the press had not played up this issue. The press reported that it was unlikely that Roosevelt would further devalue the dollar. However, according to Appert press reports suggested that the President should retain the faculty to further devalue the dollar as a form of leverage, particularly as there was some disagreement over the

[87] Quoting the original text, "*Il (les gouvernements) compte qu'aucun pays n'essaiera d'obtenir un avantage de change déraisonnable et par là de contrecarrer l'effort qu'entendent poursuivre pour restaurer des relations économiques plus stables, le Gouvernement des Etats-Unis d'Amérique, le Gouvernement de la Grande-Bretagne et le Gouvernement français.*" Source: *ibid.*

[88] see: M.F., B 32 325.

sterling/dollar exchange rate.

Appert reported that the Tripartite Agreement had been welcomed in the media as the most positive step since the failed World Economic Conference. And that this understanding between the three great democracies was a guarantee of peace and should assist economic recovery. Appert states that the trade measures announced by France, Switzerland and Italy (i.e., trade liberalisation measures) and the joint declarations by the French and UK governments in Geneva had contributed to this improved atmosphere.

However, Appert adds a significant rider, viz., that it was the view of US economists that the French devaluation had been insufficient if one considered the impact which recent social measures would have on domestic prices. Appert reports that it was their considered view that France should have devalued its currency by 40% to 50% in order to be competitive.

THE 24 HR. GOLD EXCHANGE GUARANTEE AGREEMENT:

The 24 hour gold exchange guarantee was created as a major part of the intervention armoury of the new system. Its nature was close to the proposals discussed between the Bank of England and the Bank of France. The agreement between the Bank of France and the Bank of England ensured that currencies would be exchanged at prearranged parities, which in practice might be altered several times a day. This agreement effectively removed the exchange rate risk from the intervening authority. However, when extended to the US a problem arose because market opening times did not completely overlap. When converting dollars into gold the difficulty did not arise as the dollar had a fixed parity of $35 per ounce (plus or minus 0.25% handling charge).

However, a suitable mechanism had to be found for the conversion of sterling balances into gold. It was therefore agreed that sterling balances acquired by the Fed. and held in London would, "be converted into gold in London at price fixed in London market whether on that day or on previous day or at mean between the two as Mr. Morgenthau prefers. Similarly if United States Treasury were oversold in sterling as a result of their control operations Bank of England would be willing to buy gold from them on following day for delivery in London at London price for gold determined as above."[89] The agreement would, "remain in force for an indefinite period subject to a right reserved to each side to suspend it or review it (without prejudice of course to past transactions)."[90] The statement in brackets is of course the most crucial aspect of the accord. The letter which records this agreement was sent by the Chancellor to Morgenthau and indicates that it was Morgenthau's initiative. The letter ends by requesting that any statement confirming this agreement be co-ordinated with the UK authorities.

This agreement would be the basis of the Three-Power gold pact. Jenny argued in Le Temps that the need for such an arrangement arose following the devaluation of the franc, as intervention under the old arrangements could only be transacted through the belga, the only remaining gold currency. The US would not deliver gold against currencies which did not offer reciprocity. Hence, the need to set up a scheme to temporarily guarantee the gold value of currencies acquired for intervention purposes. As no country was willing to hold foreign exchange even for 24hrs. the only alternative international currency remained gold.[91] Without the guarantee the stabilisation funds would be obliged to hold open positions on balances acquired, which they were unwilling to do. It was argued that this agreement in fact increased the British freedom of action because, "since the collapse of the gold franc, the British authorities had been powerless to prevent an undesirable appreciation of sterling unless they were prepared to carry substantial open positions in fluctuating currencies."[92]

It was, of course, paradoxical now that most countries had essentially repudiated the gold standard, at least in its pure form, that the only vehicle which still retained its international acceptability remained gold. The Financial News of 14/10/36 reported that, "The new arrangement is designed merely to assist technical co-operation between the monetary authorities, and in no way indicates any limits within which sterling will be maintained." It added that, "The announcement of the Three-Power gold pact was well

[89] see: M.F., B 32 325, 14/10/36, this document is the record of the Chancellor of the Exchequer's communication forwarded to Cochran from the Secretary of the Treasury.

[90] see: op.cit., p.2.

[91] see Jenny in Le Temps, 19/10/36.

[92] cf., The Financial News, 14/10/36.

received in the City yesterday. The reciprocal gold ear-marking facilities thus provided are regarded as essential for the smooth working of international exchange control." On the 13th October the New York Times reported that all gold flows would be conducted by national central banks through their exchange equalisation funds, in order to avoid speculation. Morgenthau announced that France and the UK were to revoke treasury licences held by private individuals and banks to transfer gold. Private holdings of gold had been forbidden in the US, the sanction against private gold transactions in the US were only lifted in the early 1970s. The 13th October *Communiqué* was extended to Belgium, Switzerland and the Netherlands.[93] This allowed co-operation between exchange stabilisation funds to be extended to these countries.[94] The 13th October accord could be revoked after a 24hr. period of notice. Apparently Morgenthau made a second announcement on 24/11/36 concerning this accord, but presumably this refers to the extension of these privileges to the Belgian, Dutch and Swiss authorities. These provisions marked the beginning of a long period of capital controls which would not be fully liberalised until the early 1980s with not altogether happy results, particularly when married with fiscal laxity.

In practice this was as far as co-operation was to go in the monetary field. The van Zeeland report, published in 1938, which called for the exchange guarantee arrangement to be extended to six months, was never endorsed.

France's devaluation marked the effective end of the Gold Bloc, though it had been apparent even to French policy-makers that after the Belgian devaluation, the Gold Bloc had but a tenuous lease on life.

Why had the French authorities waited so long? There are several reasons, the main ones being a rejection of unilateral action and dislike of devaluation. It is clear that there was continuity in French policy from the 1933 World Economic Conference, namely the desire to reach an international agreement which would endorse a return to gold as the ultimate goal. Blum tried to sell the Tripartite Agreement on these terms. However, it is clear that the French had to be content with a vague commitment on the part of the UK and US not to retaliate in the monetary field.

Comments by the two leading US policy-makers of the time help clarify the US

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[93] source: paper drafted on 23/11/36, M.F., B 32 325.

[94] see documentary Appendix.

attitude to the Tripartite Agreement. In the New York Times (26/9/36).[95] Morgenthau was asked whether the Tripartite Agreement marked, "an end of the twenty-four-hour basis of action?" He replied, "Yes and No. If the agreement affects the internal prosperity of the United States we will take steps necessary to correct. Other governments have the same privilege." The New York Times (27/9/36) quoted Secretary of State Cordell Hull as stating, "The declarations of policy amply provide for taking into account the full requirements of internal prosperity. This advance toward stability should also greatly facilitate the reduction of excessive phases of quota, exchange controls and of other excessive impediments to commerce between nations, which themselves were partly caused by exchange uncertainties."..."The step taken is in harmony with our reciprocity trade agreements program, as it is an indispensable part of our program for full and stable business recovery."

The New York Times (28/9/36) quoted J.H.Rogers congratulating the French on devaluation arguing that it would help re-establish economic order and prosperity as well as contribute to the peace of the world. The Manchester Guardian (28/9/36) referred to suggestions that the Tripartite Agreement had been made, "conditional upon the prompt opening of negotiations on France's war debt to the United States." However, it pointed out that this was doubtful and that this charge had been rebutted by Roosevelt. The rebuttal had damaged him politically amongst the isolationists ahead of the presidential elections. It is indeed doubtful that there would be a re-opening of the issue which would have undermined the agreement. The New York Times (30/9/36) quoted Sir Arthur Salter, who had been director of the Economic and Financial Committee of the League, applauding France's devaluation, on the grounds that this would lead to recovery. And Sir Henry Strakosch in the Financial News (12/11/36) argued that devaluation would tend to raise commodity prices but would not, "entail a corresponding rise in the cost of production."

Morgenthau dubbed the Tripartite Agreement, "a new type of gold standard," that would, "take the power of trading in gold out of the hands of irresponsible speculators and put it into the hands of governments,"[96] though Kemmerer remained more doubtful and was quoted in the Times stating that a revocable 24hr. stabilisation agreement in no way afforded

[95] see: Chatham House press cuttings library (C.H.P.) for newspaper articles in this section.

[96] cf., The Manchester Guardian (13/10/36).

real stability.[97] A view with which Drummond concurs.[98] Nonetheless, it was considerably more attractive than a unilateral devaluation by the French authorities without any commitment to exchange intervention.

The realignment of the Gold Bloc had begun with the return to gold of the belga on 31/3/36 a year to the day after its devaluation. The Royal decree fixed the new gold parity at 0.150632 grammes of fine gold.[99] Gold and foreign exchange held at the Belgian National Bank would be revalued on this basis. The decree also abolished the exchange stabilisation fund whose resources were transferred to the Treasury. The Belgian authorities were widely credited, following the suspension of the gold standard in 1935, with having encouraged enterprises to raise prices, particularly in the export oriented sector, in order to restore domestic profitability and avoid accusations of foreign exchange dumping[100],- though the Belgian authorities also adopted decree measures to prevent price rises having too great an impact on the cost of living. In contrast the French, Italian and Swiss authorities would adopt measures to prevent devaluation having an impact on domestic prices. The new gold parity of the belga was that at which the exchange equalisation fund had been empowered to buy and sell foreign exchange for intervention purposes.[101] Following the Tripartite declaration of 25th September 1936 Belgium issued a statement, on the 26th, to the effect that it was adhering to the agreement.

Switzerland would be the first to follow the French devaluation. The Manchester Guardian (28/9/36) records that Dr. Meyer, the President of the Federal Council and Finance Minister, had defended devaluation on the grounds that France had done so, but the clinching argument had been the Tripartite Agreement. He hoped that this would end currency wars

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[97] 14/10/36, Chatham Hse. Press.

[98] On the Tripartite monetary agreement Drummond has this to say, "The Tripartite Agreement brought a shadow of international monetary co-operation but not its substance." From Drummond (1981) p.223. Drummond (1987) is more forthright, "Surveying these developments, one has trouble understanding why an earlier generation of scholars thought the declarations of September 1936 had actually stabilised exchange rates." p.52.

[99] see: M.F., B 32 325.

[100] see Griffiths (1987); and Eichengreen Golden Fetters p.364, footnote 31.

[101] see: *Arrêté Royal* 31/3/35, M.F. B 32 325. The Monetary Law of 1935 had stipulated that the new gold parity of the belga would be stabilised between 75% and 70% of its former parity, which had been established by Royal decree of 25/10/26.

and wanted to be a party to it and pointed to the success which devaluation had had in the UK. The Manchester Guardian argued that the reason for the Swiss devaluation was manifestly economic, as the note circulation was covered up to 120% by the gold reserve of the National Bank, and maintaining the exchange rate would have seriously affected the tourist trade,- one recalls the disquiet caused by discounts on sterling payments to British tourists.[102]

The gold content of the Swiss franc was reduced from 293 milligrams to a maximum of 215mg. and a minimum of 190mg. According to the Financial News (28/9/36) the, "maximum permitted devaluation will be about 35.2% and the minimum 26.6%." The profits on gold holdings amounted to some 650 million Swiss francs or nearly £36 millions sterling. The government proposed that this be used to establish, "a compensation fund for supporting the exchange."[103] A provisional figure for the devaluation of the Swiss franc appears to have been set at 30%[104] and the markets for gold and foreign exchange were kept open.

Switzerland maintained the free movement of gold, which neither the French and Dutch did[105] and the government was granted emergency decree making powers in the economic field. The Swiss did not tax windfalls profits realised on gold holdings, as the French Popular Front attempted to, as a consequence devaluation was followed by a capital inflow. Meyer claimed that Switzerland remained on gold, though as the gold convertibility of notes was suspended such a claim would have been rejected by orthodox gold buffs. Gold would only fulfil a role in international settlements. A policy advocated by Cassel.[106]

An interesting parallel with the public debate on the devaluation issue in France is found in Switzerland. In France the Communists had opposed devaluation on the grounds that it would reduce the standard of living of workers, and in Switzerland the Socialist party is recorded as opposing devaluation and placing responsibility for devaluation on the

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[102] see chapter six of this thesis.

[103] cf., The Times (29/9/36).

[104] cf., The Times, 30/9/36.

[105] cf., Manchester Guardian, 30/9/36.

[106] see Cassel (1936).

government.[107] The Socialist party argued that profits realised on gold should be used to finance a job creation programme and that import duties be reduced on foodstuffs. The *Journal des Nations* (3/10/36) records that the Swiss did reduce import duties on such items as dried fruits, fresh vegetables, eggs and corn. The aim was to hold price rises in Switzerland to below 10%.

The Financial News (30/11/36) records that the Swiss National Bank had reduced the discount rate from 2% to 1.5%. Devaluation had also caused a boom on the stock exchange with the share index rising from 96.26 to 158.81 per cent from September 23 to November 10th. Bank shares and industrials had risen in particular, to a significantly greater degree than the rate of devaluation.[108] The article also noted that the average yield on federal bonds had fallen from 4.81% to 3.63% (i.e., bond prices had risen). The Financial News ventured that Swiss devaluation would be good for tourism and would be in the UK's interests as tariffs would be reduced and trade would increase.[109] It was hoped that cheap money would lead to economic revival. It appears that at first devaluation sparked inflationary fears, particularly as profits on gold hoards were not to be taxed which could cause gold dishoarding and be inflationary. However, devaluation appears to have been quickly accepted by the Swiss.[110] The Financial News of the 4/11/36 suggested that the Swiss franc was now undervalued.

According to a report in the Daily Telegraph (28/9/36) the Netherlands at first declared that it would not devalue, but argued that its hand was forced by the Swiss devaluation. Colijn averred that it was not so much the departure of the franc as Swiss devaluation and that in the circumstances the guilder could not remain the sole gold currency.[111] This would appear to be more of an excuse or dilatory action whilst devaluation was prepared. The Dutch authorities imposed a gold embargo and closed the stock exchange on 27/9/36. Prime Minister Colijn declared that the Netherlands would have

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[107] cf., *Le Journal des Nations*, 29/9/36.

[108] cf., The Financial News, 30/11/36.

[109] cf., Financial News, 9/10/36.

[110] cf., Financial News, 19/10/36.

[111] cf., The Times, 5/10/36.

a managed currency.[112] The Dutch adopted a managed currency, divorced from gold, with a depreciation of 15-20%.[113]

The Financial News (3/10/36) pointed out that exports from the Dutch East Indies had been seriously affected since 1929 and that devaluation would at least increase guilder incomes. To avoid a rise in prices in the Dutch East Indies import duties were decreased as well as quotas on certain goods imported into the Netherlands.[114] The Financial News reported suggestions (28/9/36) that the Dutch devaluation could have a deflationary effect on world market prices of such colonial exports as tin, rubber, tea, sugar, pepper, oil and copra.

Quoting the Manchester Guardian of 5/10/36 on the terms of the Dutch devaluation, "The Dutch simply prohibited the export of gold from Holland and the Dutch East Indies and that was all. No definite new gold parity was adopted for the unit as in the case of the Belgian devaluation eighteen months ago. No intimation was given even within limits what the new gold content of the florin would be eventually."

The Dutch created an exchange equalisation fund with resources of £40 millions sterling[115] (though the Times appears to give a figure of £24.773 million at par or 300 million guilders) whose dealings would remain secret. *Le Temps* reported (12/10/36) that following the gold embargo the guilder depreciated by 20%. Of all the former Gold Bloc member states, the new monetary regime for the guilder most closely resembled that for sterling.

On 4th November 1936 Switzerland adhered to the gold fixing arrangement existing between France, the UK and US.[116] These dispositions which were set out in a *communiqué* of 13th October (viz., the 24hr. exchange guarantee arrangements) had been extended to Belgium, Switzerland and the Netherlands by 23rd November 1936.[117]

Poland did not follow the remaining Gold Bloc countries off gold. However it was

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[112] cf., Manchester Guardian, 29/9/36.

[113] Financial News, 28/9/36.

[114] The Times, 5/10/36.

[115] cf., Manchester Guardian, 29/9/36.

[116] see: note from Minister of Foreign Affairs to Minister of Finance B 32 325.

[117] see: paper dated 23/11/36, M.F., B 32 325.

already *de facto* off gold having introduced a gold embargo in April and exchange restrictions, so that the zloty only enjoyed internal convertibility.[118] Poland appears to have waited until Germany had taken a decision on the devaluation issue. The Daily Telegraph (3/10/36) reports that Poland declared that it would not devalue following a speech by Dr. Schacht. According to the Manchester Guardian (28/9/36), "More than 60 per cent of Poland's foreign trade is governed by, "compensation agreements," and the German mark, the Italian lira, and the Danubian currencies are more important in Polish trade than the French franc." Another consideration was that devaluation would increase the cost of imported raw materials and for military reasons Poland needed access to cheap resources and Poland was a debtor on foreign account.[119] However, the decision not to devalue was followed by declines on the Warsaw stock exchange (Financial News 5/10/36). The Financial News reported on 6/10/36 that Poland was considering adhering to the Tripartite.

Amongst other central and east European currencies the Czech crown was devalued again, having already been devalued in February 1934, at the time this had caused some concern about the Gold Bloc's future.

Rumania did not devalue though. *Le Temps* reports a trip to Prague by the Governor of the Rumanian central bank, Mr. Constantinesco, on 3/10/36 to attend a conference of governors of the three Little-Entente states.[120] An article published in *Excelsior* on 10/10/36 (a Rumanian newspaper) argued that Rumania would not devalue, but follow a balanced budget policy and that its exchange rate would remain compatible with the needs of trade. The article pointed out that though the Leu (or Lei) had been nominally attached to the Gold Bloc, given the controls on foreign trade and foreign exchange it was in practice a managed currency. The Financial News quoted three exchange rates for the Lei: the official rate of 500 to the pound; a rate of some 700 to the pound; and the black market rate at 950 to the pound (12/10/36). Such disparities clearly indicate that the Lei was not a free currency. It was also suggested that devaluation would unbalance the budget by increasing

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[118] cf., The Daily Telegraph of 27/ & 28/9/36.

[119] French military credits to build railroads worth some £30 millions sterling appear to have gone ahead nonetheless cf., Financial News 5/10/36; & Telegraph 3/10/36.

[120] cf., *Le Temps*, 4/10/36.

expenditure, an argument which was often adduced during the French devaluation debate.[121] The article concluded that there was no reason for Rumania to devalue.[122]

The most interesting aspect of the failure of both the Polish and Rumanian currencies to follow France off gold is that France had nurtured a financial and political relationship with both states during the inter-war years and had been very jealous of any intervention by e.g., the British.[123] The decision not to devalue demonstrates how France's influence had waned, despite repeated loans made by the Bank of France to both states. It underlines how pre-eminent the system of central European clearing and trade centred around Germany had become. The Daily Telegraph (28/9/36) pointed out that, "The devaluation of the franc will have little effect on the economic position in Central Europe and the Balkans. There is no great trade with France in Austria, Jugoslavia, Czechoslovakia and Hungary." Though it does add that, "Rumania, however, owes large sums in francs to Paris, and will, therefore, profit by the depreciation."[124] The Financial News reported (5/10/36) that the Yugoslav dinar was already *de facto* devalued as it was operating under a system of clearing agreements.

The Times (29/9/36) announced that Latvia was leaving the gold standard and pegging her currency to sterling at the rate prevailing in 1931. The Lats was therefore devalued some 40%, it also reduced import duties to avoid price rises and moved towards abolishing quotas and currency restrictions.

Greece also linked her currency to sterling having previously maintained a link with the franc, though the *Messagers d'Athènes* suggested that the drachma had previously been pegged against the Swiss franc.[125] And the Financial News (3/10/36) announced that Turkey was tying its currency to sterling.

In the Far East Japan declined the French offer to adhere to the Tripartite arguing that

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[121] see chapter seven of this thesis.

[122] Quoting the article of 10/10/36 in the *Excelsior* on the position of the Rumanian currency, "*On voit donc qu'à aucun point de vue la Roumanie n'est forcée de procéder actuellement à une dévaluation de sa monnaie.*"

[123] see Moreau's memoirs.

[124] cf., The Daily Telegraph, 28/9/36.

[125] cf., *Messagers d'Athènes*, 29/9/36.

it was unnecessary as its currency was linked to sterling.[126] Le Temps reported (27/9/36) that the Japanese Finance Ministry was not worried about a French devaluation, but of the possible consequences of a Dutch devaluation on trade between Japan and the Dutch East Indies.

ITALY'S "RE-ALIGNMENT":

Of significance to contemporary opinion would be the way the Italian authorities reacted. Would they remain nominally on gold increasingly sheltering behind a system of autarkic defences, or join the democracies in stabilisation? In the event Italy devalued. This was greeted as a significant coup for the democracies.

It is interesting to chronicle the Italian decision to devalue in some detail, as it required a significant *volte face* for Mussolini who had declared solemnly some ten years earlier at Pesaro that the "*quota novanta*" would be maintained and that his pledge be graven in stone.

An article in Le Temps (27/9/36) demonstrates the extent to which Italy only maintained the most tenuous of links to gold. It pointed out that Italy offered a 20% export subsidy, that a tourist lira was in existence and that it bought gold above its theoretical parity in lira. The article suggested that as Italy was acting under a system of autarky and strict exchange controls it could afford to ignore the actions of its neighbours. However, following the Swiss devaluation the Italian authorities reacted and suspended all operations in French francs.[127] The Telegraph[128] pointed out that in any case Italy had been *de facto* off gold since July 1935. The Financial News (28/9/36) argued that Italy feared the impact of the devaluation of the franc on its tourist industry and that her gold reserves represented less than 12% of notes. Italy was particularly vulnerable as much of her export trade was tied up in a system of clearing agreements and quotas which brought in little gold or foreign exchange. The New York Times (29/9/36) reported that there were in effect four different lira rates, viz., the official, the tourist at -20/-30%, the unofficial or black-market lira at -60% and the

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[126] cf., Financial News, 5/10/36.

[127] cf., Daily Telegraph 28/9/36.

[128] *ibid.*

clearing liras. The Telegraph (30/9/36) pointed out that importers had had to pay a 28% premium which was used to finance exports.

On the 29th of September the Daily Telegraph reported that, "Reluctance to devalue the lira still dominates the situation. Germany's decision not to follow France and the growing conviction that Italy's true interests lie more closely with the Reich than with the states that have devalued have encouraged those advisers of the Government who are in favour of a Gold Bloc with Germany, Hungary, Austria and Poland." The Telegraph (28/9/36) suggested that Rumania could also be party to such a bloc, however the author went on to state that the idea of forming such a bloc appeared to have been abandoned. On the 1st October it was reported that the Italian stock exchange would remain closed, suggesting that the government had not yet arrived at a decision. And on the 5th the Telegraph reported that it appeared that Italy would not devalue. Measures would be taken to defend the value of state bonds and all foreign currency acquired since August 1935 would have to be surrendered. The Telegraph added that, "Italy's plan for self-sufficiency precludes countries with devalued currencies from increasing their exports to this country."[129]

On the 6th October, however, it was announced that the Lira would be returned to the "*quota novanta.*" Italian newspapers were directed not to use the term devaluation and the expression equalisation was sometimes used.[130] The Lira would be devalued from 64 to the pound to 92 or a 41% devaluation from its gold stabilisation parity. The New York Times (6/10/36) pointed out that this was almost equivalent to the rate of devaluation of the dollar. The resulting devaluation would restore the lira to its old pre-devaluation parities to the dollar and sterling, with a new rate of some 19 to the dollar. The Italian authorities argued that they did not need a stabilisation fund and the profit on gold stocks was credited to the Treasury.[131] The return to the nominal parities against sterling and the dollar established with the stabilisation of December 1927 allowed Mussolini to conveniently side-step his statement at Pesaro, that the value of the lira would remain immutable.

The Cabinet *communiqué* announcing the devaluation stated that, "Since the American

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[129] source, *ibid.*.

[130] cf., Manchester Guardian, 6/10/36.

[131] cf., Manchester Guardian, 6/10/36.

law for the stabilisation of the dollar authorised subsequent variations within a range of 10 per cent, and other important countries, including France and Switzerland, have reserved the possibility of variations in a similar manner, so our law provides that subsequent adaptations may take place within the range of 10 per cent. There will be no changes regarding Italian bank-notes and currency at present in circulation."[132]

Le Temps (7/10/36) heralded the Italian devaluation as a move towards the Tripartite countries and away from Germany. In the same vein the New York Times reported (7/10/36) that Italy's devaluation denoted a complete failure on the part of Germany to, "tie Italy to the chariot of her monetary policy." The Times (6/10/36) ventured the opinion that, "One aspect of to-day's decision which may prove of great importance is the divergence in the attitude of Italy and Germany. The reference to Signor Mussolini's general sympathy with the objects set out in the Anglo-Franco-American declaration has attracted much attention. It is reported that Germany had exerted strong pressure to keep Italy in line with herself, and Signor Mussolini's decision is being freely characterised to-night as a setback to Dr. Schacht." The Duce had stated that economic collaboration was necessary for world peace.[133] However, the *Giornale d'Italia* published an editorial on 7th or 8th of October arguing that this policy did not mark a move away from Germany. This article was published shortly after a meeting between Mussolini and the German Ambassador. *Le Temps* (7/10/36) alluded to attempts by the German Ambassador to dissuade Italy from devaluing.

What is of particular interest in the case of the Italian devaluation is the raft of accompanying measures fiscal, social and to liberalise trade. The New York Times voiced the opinion that, "The most important aspect of the lira devaluation from an international economic point of view is, it appears, the final winning over of Italy to a policy of greater liberality in foreign trade."[134] These measures would include the reduction of import duties, viz., "1) the abolition of the ad valorem duty of 10 or 15 per cent on all imports. 2) The reduction by anything up to 50 per cent of the "specific duty" imposed over and above the ad valorem duty in the last year or two."[135] *Le Temps* also records that measures

[132] cf., Manchester Guardian, 6/10/36.

[133] cf., New York Times, 6/10/36.

[134] cf., New York Times, 7/10/36.

[135] cf., Manchester Guardian, 6/10/36.

were taken to eliminate private clearing arrangements.[136]

To make the impact of the measures fairer a forced loan on land and residential property was issued. Quoting the New York Times (6/10/36) the, "decrees embody measures for distributing the burden accruing from devaluation as evenly as possible among all classes." All owners of real estate would have to contribute 5% of the value of their property.[137] This was to subscribe to 25 year bonds bearing five per cent interest. Those without the liquidity to pay cash would have a number of years to subscribe,- one can't imagine that there were many who would not avail themselves of such a facility! In order to amortise the loan the real estate tax would, "be increased by 3.5 lire per thousand."[138]

The proceeds of the loan would go towards colonial development and national defence. These measures were aimed at deterring a flight from securities into real estate. To make equities more attractive the upper limit of 6% on distributed dividends imposed in February 1935, which had funnelled any dividend surpluses into State bonds was lifted. Nonetheless, dividends above the 6% limit would be subject to a steeply progressive tax, with an exemption if surplus dividends were invested in the colonies. On the matter of import liberalisation the New York Times commented, "The import duty varying from ten to fifteen per cent, applied in September, 1931, immediately after the pound's devaluation, on goods from all countries with depreciated currencies, has been abolished. It is hoped in this way to compensate for the higher price that will have to be paid in depreciated lire for foreign raw materials."[139] On the trade front the Cabinet authorised, "the head of the government and the Minister of Finance to ease or suspend whenever they deem it necessary restrictions at present in force hindering the free passage of goods and capital across the Italian frontiers."[140]

The Times and Financial News both record that after the stock exchange was re-opened, on the 8th, the bourse boomed. However, the extent to which the lira remained a managed currency is illustrated by the fact that the tourist lira, available at a 100 to the

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[136] cf., *Le Temps*, 6/10/36.

[137] cf., Manchester Guardian.

[138] cf., New York Times, 6/10/36.

[139] cf., New York Times, 6/10/36.

[140] cf., New York Times, 6/10/36.

pound, still stood at a discount.

The social aspect of the measures was aimed to prevent increases in the cost of living. The prices of the following goods were to be frozen for two years: primary necessity foods, rents, gas, electricity and transport.[141] As we will see when we look more closely at the French monetary policy during the Gold Bloc era[142] the French authorities accompanied devaluation by lifting some 106 quotas, reduced tariffs by 15% to 20% and froze certain basic prices,[143] though a sliding scale form of wage indexation advocated by the communists was not adopted. The New York Times (6/10/36) recorded that the US markets approved of the Italian devaluation. The same edition carried Cordell Hull's praise for the devaluations and lowered import duties in France, Switzerland, the Netherlands and Italy. Cordell Hull stated that, "This is part of the general movement toward simultaneous action that some of us have been preaching for the past three or four years."[144]

CONCLUSION:

The Gold Bloc was finished and Europe became increasingly crystallised between two blocs: central and east European currencies based on clearing agreements at the hub of which stood Germany, and the west European states which resorted to a co-operative system of managed exchange rates. The second group accompanied their devaluations by measures aimed at liberalising trade both as a *quid pro quo* for Anglo-American acceptance of the Tripartite Agreement, and in order to reduce imported inflation. In fact what had happened in an *ad hoc* fashion was that the major countries had in fact devalued against gold. This helped raise the price level and stem deflation. Domestic production enjoyed more buoyant demand conditions as the burden of deflationary macro-economic policy was relaxed, as a result there was less need to protect domestic markets. That is, contrary to the view commonly held (*vide* Nurkse), currency devaluation and trade liberalisation went hand-in-hand.

In France fiscal and monetary policy both became considerably looser, due to

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[141] cf., *Le Temps*, 7/10/36.

[142] see chapter nine of this thesis.

[143] cf., New York Times, 5/10/36.

[144] cf., New York Times, 11/10/36.

increased defence spending and an accelerated deterioration in France's public finances with a monetisation of the ensuing deficits. The collapse of the Gold Bloc ended any pretence at the financial influence which France had once wished to exercise.[145]

The franc was floated under Finance Minister Georges Bonnet in June 1937, with the minimum gold parity as determined by the Blum devaluation becoming the new maximum gold parity of the franc. The final ignominy came in May 1938 when Finance Minister Marchandeau pegged the franc's new minimum parity at 179 francs per pound sterling. This undervalued the franc and as confidence returned,[146] particularly when Reynaud became Finance Minister (1/11/39-21/3/40), capital flowed back.

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[145] see Moreau's memoirs.

[146] see: Sédillot (1953).

CHAPTER 9

MONETARY POLICY IN THE GOLD BLOC PERIOD

"Nous n'entendons pas combler les dépenses de notre programme par une opération monétaire. Le pays n'a pas à attendre de nous un coup d'Etat monétaire, ni à redouter de nous que nous couvrions, un beau matin, les murs des affiches blanches de la dévaluation."[1]

The object of this chapter is to offer a broad conspectus of French economic, monetary and exchange policy over the period 1933-1936. The main focus will be on the year 1935. It is hoped that a critical analysis of this period will dispel two widely held beliefs, viz., that, the Bank of France was particularly obdurate when it came to providing assistance to governments of the left; and, the Popular Front was responsible for the devaluation.

Regarding the first charge we will demonstrate that just as Governor Robineau had refused to guarantee a stabilisation loan of $100 million in 1926, which had been a cause of Robineau's dismissal by Caillaux in 1926, so Governor Moret (1930-35) refused to support the Treasury policy, initiated by Finance Minister Germain-Martin under the premiership of Flandin, of borrowing short by means of more generous discount facilities for Treasury bills in order to take the burden off the long term rate of interest. Moret's intransigence on this and other issues would lead to his dismissal by Germain-Martin, no inflationary hot-head,[2] in 1935, and replacement by Governor Tannery (1935-36) former head of the *Caisse des Dépôts et Consignations* who would prove more pliable. However, eventually even Tannery would only agree to extend accommodation to the Treasury in May 1935 on condition that Flandin request decree-making financial powers to support his economic policy U turn. These were denied and paved the way for the final effort at deflation under Laval. After Laval's fall government had to rely on a £40 millions sterling loan from a syndicate of

[1] Extract from Blum's speech of 6/6/36, quoted by Colomb in the Chamber of Deputies during the devaluation debate 28-30/9/36.

[2] see chapter seven.

British banks and increasing rediscount of treasury bills (*avances indirectes*) to see it through to the elections and the formation of the Popular Front government. What is apparent is that the Bank did not undermine governments of the left in particular, but, rather, supported the most orthodox fiscal and monetary policies.

This led to often bruising confrontation with government, more often than not the Bank had, in the end, to provide accommodation. It is easy to vilify the Bank for confrontation which stemmed from lack of fiscal consensus at a political level. When this could not be resolved government turned to the Bank for funds. Resistance by the Bank bred resentment of its role from both the left and centre-right of the political spectrum (e.g., Germain-Martin, and Caillaux). Of course, the fiscal problem was made worse by the over-valued gold parity. But, there was a predominant political consensus in favour of this and the Bank cannot carry the blame on this count. The gold value of the currency was a matter for parliament, and the Bank was entrusted with defending the franc's gold parity. With this in mind it is apparent that the Bank was more of a scape-goat than at the root of financial difficulties.

On the second charge, that the Popular Front was responsible for devaluation it will be demonstrated that the left inherited an appalling Treasury position with a significant proportion of short-term debt which would have to be refinanced, not least among its burdens would be the need to refund the British loan. We will see that under Flandin and Laval, from November 1934 to end-January 1935, the bad old ways had returned. There was increasing resort to "*avances indirectes*,"[3] as well as borrowing from financial institutions on the expected proceeds of forthcoming loans.[4] Eventually the account for direct advances from the Bank of France to the Treasury, which had been closed with the stabilisation law of 1928, would be re-opened. Upon coming to office the Popular Front government at least had the courage to regularise the situation. Auriol the Finance Minister, and Blum, the Prime Minister, have often been charged with duplicity for rejecting devaluation in their public statements both before and after taking office. However, as Auriol would argue in his defence, to have declared one's hand would have precipitated a run on the currency.

A critical study of policy during 1935 should make the later financial debacle more

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[3] see Wolfe (1951).

[4] see Mouré (1991).

understandable. This is by no means meant to exculpate the Popular Front for its serious policy mistakes,- not least the lack of measures to restore confidence which should have accompanied devaluation.

It is important at the outset to understand that the Popular Front constituted a broad coalition of interests, incorporating communists, socialists and radicals. We have seen in our chapter on the devaluation debate that the communists would remain thoroughly opposed to devaluation,[5] whilst Blum, in 1934, evinced far more open-mindedness on the issue. Bearing in mind Kaleçki's (1938) charge that the Blum experiment failed because exchange controls were not introduced one should recall that the radical-socialists for their part opposed exchange controls and were not happy with devaluation either. Perrot (1936) was of the opinion that no party advocating devaluation could have won the elections.

As we saw in chapter four from 1930 on governments responded to the depression with deflationary policies. The Herriot government which was returned after the 1932 elections continued on the same deflationary course as its centre-right predecessors, and Herriot had the orthodox Germain-Martin as his Finance Minister. The successive radical governments which followed Herriot's government also pursued "sound" orthodox deflationary policy. However, one should note that with the onset of depression, the days of buoyant revenue (the so-called "*Trésor Chéron*") were at an end, and on May 11th the Treasury began to issue bills. Mouré records that this had not happened since 1928,- the FRF 5bn. ceiling having remained intact.[6] This ceiling would soon be lifted, and government would also have to have resort to borrowing from the "*Caisses.*"

Germain-Martin would point out that though Herriot ostensibly fell on the question of continuing war debt payments to the US his real difficulties lay in securing sufficient parliamentary support amongst a large faction of radical-socialists for his policy of deflation and expenditure cuts.[7] The fall of the Chautemps government was to demonstrate how difficult it was to pursue a deflationary policy within a fractious parliamentary regime. The

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[5] see chapter seven of this thesis.

[6] Mouré (1991) p.161.

[7] Quoting Germain-Martin (1936) on the Herriot government's difficulties in securing parliamentary support for its deflationary policy, "*Sa politique de la réduction des dépenses s'était heurtée à l'attitude d'une grande fraction du parti radical socialiste qui n'acceptait pas de prendre la responsabilité des mesures d'économie.*" p.224.

Chamber of Deputies refused to endorse his proposed revenue increases and his fall made way for a short-lived Daladier government from 30th January to 9th February 1934.

One should note that governments were caught in a Catch-22 position, viz., to maintain confidence in the currency they needed to balance the budget, but the cause of the deficit was due to the effects of the over-valued exchange rate on economic activity and the government's non-accommodating fiscal stance. As Eichengreen records,[8] as a result of sterling depreciation and later the dollar domestic spending had to be reduced, which meant budgetary deflation,- but no lasting coalition existed to implement the necessary measures, viz., either higher taxes or expenditure reductions. A combination of both would usually be tried, however the tenuous nature of political coalitions and divisions over the relative burden of adjustment led to protracted instability relieved by short-term grant of decree-making authority.

Germain-Martin argued that in the period 18/12/32-9/2/34 six governments had fallen attempting to implement an economic policy aimed at matching expenditure with receipts, i.e., pursuing deflation. This lasted until Doumergue formed his cross-party coalition government of national union.[9] The two politicians who would occupy the finance ministry for most of this period were Louis Germain-Martin and Georges Bonnet. They served under six different prime ministers over the period 3/6/32-1/6/35 confirming Olé-Laprunne's thesis (1962) that changes of government masked a great deal of continuity in office and in the political personnel.[10] Both men took turns at the *rue de Rivoli* almost continuously, with two short interludes not exceeding one month in all. Instability was an epiphenomenon

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[8] Golden Fetters, p.355.

[9] Germain-Martin (1936) pointed to the intractable difficulties of securing parliamentary support for a deflationary economic policy, "*Depuis le 18 Décembre 1932, date de la prise du pouvoir par le Ministère Paul Boncour, jusqu'au 9 février 1934, date de la formation du Ministère Doumergue, six Ministères se succèdent et succombent par suite du refus du Parlement d'approuver la politique d'ajustement de la dépense à la recette.*" p.227.

[10] Quoting Olé-Laprunne (1962), "*Dans la plupart des portefeuilles gouvernementaux, la stabilité du personnel est double de celle du ministère,*" over the period 1870-1940. (p.41). And, "*C'est donc le développement de la continuité des ministres dans la succession des gouvernements qui donne, en fin de régime, son allure spécifique à la stabilité. Il est alors possible de parler de "permanence," de "pérennité." Aucun substantif ne peut donner une idée exacte d'un tel phénomène. L'instabilité gouvernementale, si souvent décriée, perd une grande partie de son importance.*" (p.246). "*Ainsi nous le notions au début de cet ouvrage, il peut paraître paradoxal de parler de stabilité à propos de la III République et plus surprenant encore, de faire de la crise gouvernementale la clef de la stabilité des ministres. Ces conclusions ne sont pourtant que les fruits d'analyses aussi minutieuses que possible.*" (p.295).

which disguised the constant of an intractable fiscal deadlock.

The riots of February 1934 which followed the Stavisky scandal precipitated a crisis of the state and a rallying of parliamentary parties.[11] They recalled former President Doumergue to head a cross-party government of national union, *Union Nationale*.[12] The scandal had brought down the Chautemps government and the riots that followed had led to Daladier's resignation.

The Doumergue government did not include representatives of the Marxist parties, viz., the socialists and the communists.

Doumergue, invested with decree-making powers, reduced expenditure on specific items by executive fiat, e.g., pensions, rents, etc. However, his initiatives in the constitutional field, namely his advocacy of a strengthened executive and his use of radio-broadcasts, were construed as a means of by-passing parliament. This combined with the unpopularity of deflation by decree, and the waning of the threat from the Leagues, eroded his support in parliament. Doumergue's proposed constitutional amendments, which would have strengthened the executive, lost him the support of the radicals[13] and his government resigned on 8th November. Doumergue returned to permanent retirement[14] and under his successor, Flandin, constitutional reform was shelved. It is under Doumergue that Reynaud had launched his thinly veiled campaign in favour of devaluation in a speech on 28th June 1934, exactly six years after the Poincaré stabilisation.

Flandin (Prime Minister 8 November-31 May 1935), who was said to have been influenced by Roosevelt's New Deal, rejected deflation. Deflation had already been tried under two separate guises, viz., a general deflationary fiscal stance and deflation by decree, which had been pursued under Laval and Doumergue (and again under Laval in the second half of 1935). The advocates of the latter option could argue that it might be swifter and fairer, e.g., by administratively reducing rents, but it is paradoxical that in pursuit of a liberal economic model the executive should be drawn into altering private contractual agreements! Flandin retained Doumergue's Finance Minister Germain-Martin who would

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[11] see chapter one of this thesis.

[12] Mayeur (1984) p.338.

[13] Mayeur (1984) p.341.

[14] see: Survey of International Affairs (1934) p.24.

serve at this ministry during the period 4th February 1934 to 31th May 1935. Germain-Martin would now implement a completely different policy. Flandin's policies aimed at encouraging cartelisation (the antithesis of economic liberalism) amongst industries,[15] supporting the price of wheat, and reducing the long rate of interest by borrowing at the short end of the yield curve, taking pressure off the long rate and thereby, hopefully, stimulating investment.

Flandin favoured a relaxation of the discount policy of the Bank of France, in particular the discount of bills to finance his wheat price support scheme. But the Governor of the Bank of France, Moret (appted. 25/9/30), failed to provide the accommodation. This, and the refusal of the Bank to assist Citroën,[16] brought about Moret's dismissal on 2nd January 1935.

Quoting Myers (1936) on this change in Bank of France discount policy, "A more radical change was that made in the early months of 1935, when a Treasury crisis brought about the extension of the rediscount privilege to National Defence notes and Treasury notes of more than three months maturity."[17] Governor Moret of the Bank of France was unwilling to do this, but was replaced by Tannery who had been head of the *Caisse des Dépôts et Consignations* (a very large state owned investment bank which held and managed funds such as post office savings deposits).[18] The "*Caisse*" already had a policy of lending against similar collateral as that which the government was proposing to make eligible for discount at the Bank. On Tannery's appointment this policy was pursued. And, "the Bank was to make loans for periods up to thirty days on the security of Treasury obligations of less than two years' maturity."[19] The ceiling on Treasury bill issues was also raised. Quoting Eichengreen, "The ceiling on Treasury bill issues was raised 50 percent, and the Bank of France agreed to extend 30-day advances to private borrowers offering treasury bills as

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[15] see Jackson (1985).

[16] see: B.F., "*dossiers gouverneurs.*"

[17] Myers (1936) p.16.

[18] For a history of the *Caisse des dépôts* and its activities see Priouret (1966).

[19] Myers (1936) p.17.

collateral."[20] The Treasury bill ceiling now stood at FRF 15bn.[21]

Myers suggested that the activities of the *Caisse des Dépôts et Consignations* could be deemed similar to open-market operations, or that it could potentially have been used to fulfil that role, whilst by-passing the injunction against the Bank of France engaging in such operations.[22] Mouré quotes Germain-Martin as saying as much.[23] The "*Caisse*" helped sustain the market value of the *rentes* and government credit, as well as the stock-market. Myers pointed out that the Governor of the Bank of France was an *ex officio* member of the Council of the *Caisse des Dépôts et Consignations*. The *Caisse d'Amortissement*, created in 1928 and charged with funding the floating debt and the management of the *Crédit National* (the fund for repairing war damages),[24] was also under the control of the *Caisse des Dépôts et Consignations*. One should also note that the Bank of France would discount the anticipated proceeds of post office and railway bond issues,[25] and the three largest Paris commercial banks (the *Société Générale*; the *Crédit Lyonnais*; and the *Comptoir National d'Escompte*)[26] provided assistance to the Treasury by purchasing Treasury bills, as indeed would the *Caisse des dépôts*. An excellent account of Treasury difficulties during the period 1934-36 is to be found in Mouré.[27]

Moret was angered at his dismissal, as is attested in his last meeting of the *conseil de régence* (as it was known before the alteration of its statutes under the Popular Front, when it became the *conseil général*) of the Bank of France.

A continuing budget deficit, and the Belgian devaluation of March 1935, caused a run on the franc in May 1935 and the Bank of France's discount rate was raised from 2.5%, in stages, to 6% on the 28th. Flandin's difficulties were compounded by the Municipal

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[20] Golden Fetters, p.368.

[21] see Jackson (1985) p.225.

[22] Myers (1936) p.66.

[23] Mouré (1991) p.174.

[24] Myers (1936) p.79.

[25] Mouré (1991) p.176.

[26] see Mouré (1991) p.177, footnote 94.

[27] Mouré (1991) pp.156-190.

elections of 5-12th May 1935 which pointed to a Popular Front electoral victory in the parliamentary elections to be held in the following year. Mouré (1991) points out that gold losses in the week 23-30th May 1935 amounted to FRF 5bn. By mid-May the Bank had also lost its secret gold reserve of FRF 450 million held at the *Caisse des dépôts*. This was not reconstituted.[28]

Flandin's government sought emergency powers to staunch the financial crisis caused by the budgetary situation and fear of devaluation[29],- a reversal of policy for Flandin,- but the bill proposing these was defeated in the Chamber of Deputies and the government fell on 30th May.[30] In order to try to restore confidence Flandin had, in April, even resorted to announcing that new gold francs would be issued, but even this failed. His fall very nearly precipitated an exchange crisis. The British Exchange Equalisation Account bought francs and the US Treasury made a loan of $150 million to support the franc. Only $34 million of it was used.[31]

Flandin was succeeded by a short-lived Bouisson government, with Caillaux at the Finance Ministry. Caillaux by then was in favour of a stabilisation of the international exchanges,[32] which presumably would have encompassed a devaluation of the franc. However, the government was refused plenary powers. This was the second time that Caillaux had been refused plenary powers. The first had been in 1926 when as Prime Minister he failed to secure the authority to implement the Sergent committee recommendations, though Caillaux's appointee as Governor of the Bank of France, E.Moreau, would have a significant hand to play in securing the Poincaré stabilisation.[33]

Laval's government, which lasted from 7th June 1935 to the constitution of the interim Sarraut government of 24th January 1936,- until the Popular Front came to office on 4th June 1936,- demonstrated the impossibility of continuing with a policy of deflation.

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[28] see Mouré (1991) p.147, footnote 98.

[29] see: Survey of International Affairs (1935).

[30] see: Survey of International Affairs (1935) vol. I.

[31] Clarke (1977) p.10.

[32] see: Survey, ibid. p.390.

[33] see Moreau's memoirs.

Laval secured plenary powers and began a policy of deflation, *à outrance*. This policy proved unpopular and was instrumental in the electoral success of the Popular Front. However, the paradox of Laval's period in office is that though deflation was pursued with a vengeance there was a considerable monetary easing. The government's Treasury position had become so untenable that there remained no option but to pursue the policy initiated under Flandin of resort to indirect advances from the Bank of France. Laval also got the *Caisse des Dépôts et Consignations* to, "help out by investing in an additional amount of bons."[34]

One should also note that as budgetary difficulties became more pressing Laval created a *budget extraordinaire* to the tune of 6,230 million francs to finance armaments and civil expenditure (*fonds d'outillages et d'armement*). This artifice allowed him to present an ordinary budget which appeared in balance, whilst the extraordinary budget could be financed by the additional issue of Treasury bills outside the mandated ceiling. Mouré records that this raised the effective Treasury bill issue by FRF 5,885 million.[35] Any semblance of transparence in public accounts was clearly fast disappearing. Though the increase in Treasury bills occurred under Sarraut's government the mechanism had been put into place under Laval. This subterfuge which allowed the government to pretend that it was presenting a budget near balance had to be resorted to once the product of a £40 millions sterling loan (FRF 3bn.) contracted from a consortium of British banks, in February 1936, had been exhausted. One should note here too that negotiations for the loan had begun in the dying days of Laval's government.[36] As we will see the Bank of France only very reluctantly agreed to make an equivalent gold deposit in London to reassure the syndicate, whilst denying that this should in anyway serve as collateral.

Wolfe (1951) pointed out that the policy of "*avances indirectes*" offset the deflationary sterilisation of note circulation which resulted from the substantial gold outflows of the period, as notes were redeemed for gold. Figures in Sauvy indicate that Bank of France gold reserves fell by 15bn. francs between 1935 and 1936,[37] whilst the level of "*avances*

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[34] source: Wolfe (1951) pp.118 & 166.

[35] Mouré (1991) p.185.

[36] see Mouré (1991) p.184, footnote 122.

[37] source: Sauvy (1984) vol.III, p.393.

indirectes" later regularised by Auriol amounted to 14bn. francs. Wolfe argued that the reason the fiscal crisis in the period 1925-26 resulted in inflation was that the gold standard had been suspended. During the period 1935-36 increases in note circulation arising from "*avances indirectes*" and later "*avances directes*" were automatically sterilised by gold outflows. Later the exchange stabilisation fund would act as an intermediary accumulating francs through its intervention operations. These were surrendered for gold at the Bank of France.

The facility for direct Bank of France discounts of Treasury bills, opened in February 1935, had been undermined by de Wendel's insistence that these be carried under a specific rubric within the Bank's balance sheet as, "advances against public funds."[38] Mouré also suggests that the minutes (*procès-verbaux*) of the Bank of France were altered to disguise the extent of disagreement between Tannery and the regents of the Bank over his proposals for wider discount facilities.[39] This is easily believable, certainly the minutes of the Bank provide the most terse and anodyne record of decisions taken (rather than any insight into the tenor of the debate). Of greater use and insight is the correspondence between the Treasury, the Finance Ministry and the Bank of France.

The extent of financial uncertainty and treasury difficulties in the period May 1935 to May 1936 is recorded by two telling indicators, viz., current accounts at the Bank of France fell by 50%, whilst commercial discounts rose from FRF 4bn. to FRF 17bn. the virtual totality of which was accounted for by treasury bill rediscounts. These provide evidence for Eichengreen's view,[40] which I share, that providing accommodation in such circumstances merely feeds the capital outflow in the form of gold reserve losses. Though here the accommodation was not being extended to an over-stretched banking system, as in Belgium, but to the government. The Bank was well aware of this and realised that a rise in the discount rate would therefore have little effect (see below).

Sauvy (1984) denoted a slight pick-up in economic activity from May 1935 to May 1936 and it is undoubtedly to this monetary easing that any recovery was due. Nominal

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[38] see Mouré (1991) p.175.

[39] Mouré (1991) p.175.

[40] see Golden Fetters.

wage illusion suggests that any Pigou effect[41] due to increases in, e.g., civil servants' real incomes, were offset by the psychological impact of decreed cuts in nominal salaries.

In 1935 Laval introduced 10% across the board cuts. This was greatly resented by civil servants, although their real standards of living had never been so high.[42] However, Sauvy argued that the lack of published price indexes masked this improvement in purchasing power, for those in employment. Lack of published data, he believes, tended to make the depression look worse than it was as those figures which were available tended to overstate the degree of depression, such as French unemployment figures which were not seasonally adjusted and the British unemployment figures for the insured labour force which included a greater proportion of workers in the capital goods sector (which was more heavily affected by the depression) than the national average.

The franc was weak throughout Laval's term of office, belying the contention that only governments of the left were subject to such "assaults". The weakness of the franc may be ascribed to the budgetary situation, the Belgian devaluation which demonstrated how tenuous an arrangement the Gold Bloc was, and the increasing likelihood that the Popular Front would win the forthcoming elections,- particularly after the local elections of May 1935. Eichengreen gives the following figures for gold losses in 1935, France lost 20% of its reserves; the Netherlands 25%; and Switzerland 40%.[43]

Having given a broad overview of the governmental changes ahead of the accession to power of the Popular Front it is perhaps useful to look at the records of the Bank of France for a better insight into the rapid treasury and monetary deterioration during 1935.

Tannery's tenure at the Bank of France marked an immediate change in the Bank's attitude to the government. On the 21st February 1935 Tannery proposed that government paper should be discounted by the Bank. Paper eligible for this facility would have a maximum maturity of two years, discount would be for three months non-renewable. The

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[41] Quoting Hawtrey (1970), "The fall of prices, so far as actually accomplished is a relief; it makes a given amount of money-demand absorb a greater amount of goods. The difficulty of reducing wages prolongs the depression, because it obstructs the fall of prices." p.321. This quote both describes the "Pigou effect" as well as the classical explanation for unemployment, viz., high reservation wages. However, this form of analysis is static and does not take account the process of cumulative deflation which can set-in as income and sales fall and real debt burdens rise, i.e., there is a complete lack of dynamic macro-economic perspective.

[42] see Sauvy (1984).

[43] Golden Fetters, p.367.

rate could not be inferior to the official discount rate. At the meeting de Wendel argued that this facility should be subject to a maximum ceiling of 25bn. francs and published under a separate rubric.[44] This would of course reduce the appeal of such a facility, as it would make the government's treasury position immediately apparent. The strain under which the franc was placed in May 1935 is illustrated by the fact that the Bank of France received $150 million to support the franc on the 31st and a further $50 million from the Guaranty Trust Company.[45] The US requested assurances that the Bank of France would be able to deliver gold against this loan, and the Bank of England requested similar assurances on gold held at the Bank of France. US fear of a possible gold embargo was registered again on 6th June. These fears were of particular concern as the franc was being supported with dollars. In order to stem speculation against the franc the *conseil général* of 13th June 1935 notes that new advances/borrowing against gold had been suspended for the last few weeks and that the suspension of the facility was not out of the question. Borrowing against deposit of gold afforded the speculator a perfect hedge, unless of course a devaluation did occur and the gold was returned at the new parity in which case foreign exchange gains would be offset by losses on the gold deposited as collateral.

That the Bank practised "moral suasion" is clearly evidenced in discussions concerning a reduction in the discount rate from 5% to 4%.[46] In approving the measure, the Governor recommended that private banks should continue to be cautioned not to finance forward operations on gold or foreign exchange, but only commercial transactions.[47] The minutes of the meetings of the *conseil général* make it clear that it was concerned at the effect which high interest rates would have on business and confidence. Though the gold drain continued for a short-while on Laval's advent to power confidence returned once he had secured decree-making powers, and by 8th August the discount rate had fallen from 6%

[44] see: B.F., *Délibérations du Conseil Général* n.125.

[45] see: B.F. *Délibérations du Conseil Général* n.125.

[46] see: B.F., *Délibérations du Conseil Général* n.125.

[47] Another instance of moral suasion is illustrated in the minutes of the Bank of France when discussing whether or not to lower the discount rate. Fournier argued on 9th January 1936 (see: B.F., *Délibérations du Conseil Général* n.126) that this could be done with little risk, by enjoining banks to restrict their rediscounts at the Bank. Quoting the original, "*Pour éviter qu'il soit fait appel abusivement à nos escomptes, il suffit d'agir sur ces quelques banques en leur expliquant la nécessité de limiter leurs présentations.*"

to 3%.[48]

However, the government was facing Treasury difficulties and needed 3bn. francs for the period to September. The government felt that the time was not ripe for issuing a loan and it would therefore need accommodation from the Bank of France and the *Caisse des Dépôts*.[49] The means by which the government was to secure its needs provides a clear instance of "*avances occultes.*" The minutes of the Bank of France record that similar facilities had been offered to the Treasury to cover its needs till end-June. The Bank had discounted 500 million francs worth of bills, 250 million of three month bills with the rest having already fallen due. The government would therefore ask the banks to discount 250 million worth of bills, i.e., refund those falling due. The minutes stipulate that the banks would have to be guaranteed that they would have the facility to rediscount these bills at the Bank should the need arise. A clear instance of contingent "*avances occultes.*"

The minutes argued that as the government needs till the 15th August amounted to 750 million francs the remaining 500 million would be provided in the following way, the banks would be asked to discount a further 250 million worth of bills part of which they could be expected to rediscount at the Bank (*avances occultes*) and 250 millions worth would be bought by the *Caisse des Dépôts et Consignations*.[50]

After the 15th, the *Caisse des Dépôts* was willing to buy a further 1bn. francs worth of bills, having already done so in June, so long as a similar facility to rediscount the paper at the Bank of France was guaranteed in case of a run on savings institutions' deposits, which the *Caisse* managed. In other words the Bank of France had committed itself to a contingent liability to rediscount up to 2 billion francs worth of Treasury bills within the coming months. The canons of financial prudence would continue to be flouted. The minutes of the *conseil général* make it clear that the *Caisse des Dépôts* gave significant assistance to government by subscribing to Treasury issues.

The Sarraut government which succeeded Laval's on 24th January 1936, faced Treasury difficulties and opted to borrow £40 millions sterling (FRF 3bn.) from a consortium

[48] see: Survey of International Affairs, (1935), vol. I.

[49] B.F., *Délibérations du Conseil Général* n.125.

[50] B.F. *Délibérations du Conseil Général* n.125.

of British banks.[51] The decision was announced on 17th February 1936.[52] The assistance of the Bank of France was requested. However, the Bank refused on the grounds its statutes prevented it from acquiring foreign exchange except as a means of obtaining gold. It was also argued that this would amount to an advance to the government and that that account had definitely been closed by the monetary law of 25th June 1928. The British consortium agreed to open a credit to the French Treasury for £40 millions sterling for three months twice renewable (it would eventually fall due during the first Popular Front government's tenure of office).

The modalities of the agreement are of some interest. As the British Exchange Equalisation Account could not supply gold or francs it was agreed that gradual drawings would be made as the Bank of England purchased, on account, French francs. The Bank of France would sell sterling at rates to be agreed between both parties. The Bank of England would also buy gold and dollars, if needed. On the question of refunding the loan it was agreed that sterling would not be purchased by the Bank of France without the agreement of the Bank of England.[53] In case funds were not made available fast enough then the Bank would agree to rediscount Treasury bills until the sterling balances could be sold.[54] In such circumstances it was agreed that a scheme would be found in order that the Treasury would not pay interest twice on the funds borrowed, once in London and again in Paris. Significantly such discounts would not be counted as part of the note circulation.

However, the discount of additional paper by the Bank of France would mean that the maximum limit on Treasury short term debt, which stood at 15bn. francs, risked being overshot by up to 1.5bn. The level of outstanding Treasury bills stood at 13.5bn. francs. The solution which the Bank found reveals the extent to which the authorities were willing to engage in "window-dressing" to maintain the pretence that they were conforming to monetary statutes. The minutes of the Bank of France record that the *Caisse des Dépôts* held 2bn. francs worth of three month Treasury bills in its portfolio (presumably these were the

[51] see also Mouré (1991) pp.184-185.

[52] see: B.F. *Délibérations du Conseil Général* n.126; and Survey of International Affairs (1935) vol. I.

[53] B.F., *Délibérations du Conseil Général* n.126.

[54] Quoting from the minutes of the Bank of France, "*...la Banque accepterait de réescompter des Bons du Trésor en attendant que la conversion des livres puisse s'effectuer.*" (see, B.F., ibid., n.126).

bills originally bought under Laval to which the *Caisse* had renewed its subscription).[55] The Treasury would take these bills off the books of the *Caisse* and in exchange give the *Caisse* bills with a two year maturity. Bills of this maturity were not included in the maximum Treasury issue, as a result the Treasury could keep within the prescribed limits, with 500 million francs to spare.[56] This is how Eichengreen tersely summarizes the situation, "The statutory limit on Treasury bill issues was technically breached in January 1936. A 3 billion franc foreign loan was obtained, but it sustained the government only temporarily."[57]

However, the *Caisse* required a guarantee that it could be assured rediscount facilities at the Bank of France should savings banks (whose deposits it held in custody) be subject to substantial withdrawals. This required that funds held by the *Caisse* be liquid. The Governor of the Bank recommended that the discount facilities on bills nearing maturity be maintained but also accepted the possibility that two year Treasury bills be accepted as collateral for thirty day loans up to a maximum of 2.5bn. francs. This facility had never exceeded 1.4bn. francs and it was thought that the 2.5bn. ceiling allowed a sufficient margin.[58]

The meeting then discussed the question of refunding the British loan. The Bank of England had requested that the Bank of France hold under ear-mark in its vaults or in London balances in gold or sterling equivalent to the amount of the loan used up to date. The minutes of the Bank of France record emphatically that this did not constitute a loan guarantee on the part of the Bank of France,[59] but was merely in order to set the mind of

[55] B.F., ibid., n.126, pp. 70-71.

[56] The £40 millions sterling loan being worth some 3bn. French francs, if the Bank of France were to advance the full amount by discounting Treasury bills this would have brought the issue above its 15bn franc ceiling from 13.5bn. to 16.5bn. However, as the total amount of short-dated Treasury bills would be reduced by 2bn. by swapping existing short-dated bills held at the "*Caisse*" for two year bills, in the worst of cases the maximum outstanding Treasury bill circulation would stand at 14.5bn. French francs. For details see also Mouré (1991) p.184.

[57] Golden Fetters, p.372.

[58] B.F., ibid., p.71.

[59] see: B.F., ibid., n.126.

the British banking consortium at rest.[60]

In March it was the turn of Montagu Norman to ask Governor Tannery if he would agree a short-term loan to support the sterling exchange against gold.[61] The Regents of the Bank were informed of this request, which was meant to remain highly secret, and agreed. Gold was to be ear-marked for the account of the Bank of France at the Bank of England or debited from gold held at the Bank of France for the Bank of England. The loans would be for a sum of up to 1bn. French francs which was equivalent to the largest loss of gold which had occurred on any one single day.[62]

The French government's Treasury position was coming to a head. Mouré records that, "By March 1936 advances from the Bank of France were the only means left to avert Treasury bankruptcy."[63] The minutes of the Bank for 26/3/36 record a request for assistance by the Treasury.[64] The Treasury was in difficulty, military expenditure had increased; the government was unable to raise long term loans on the market under existing conditions; pressure was mounting on the Treasury as bills falling due were not renewed (a similar process had taken place during the 1924 financial crisis); and the *Caisse des Dépôts* was suffering from a withdrawal of deposits from savings banks (*caisse d'épargne*). This spurred the Finance Minister, Marcel Régnier, to request assistance. Legislation was passed on 15/3/36 which raised the outstanding limit on Treasury bills by the extent of national defence expenditure falling under the heading, "*...fonds d'armement, d'outillage et d'avances sur travaux*," that is by 5,882 million French francs. The Bank remained somewhat wary, but considered making an advance to the government of 2.5bn. francs until the loan could be raised. As a further immediate source of funds it was agreed that the Bank would rediscount the next day 1bn. francs worth of three month Treasury bills held by the *Crédit*

[60] Quoting the minutes of the Bank of France, "*Il ne s'agit pas là d'une garantie fournie par la Banque de France - garantie que M. le Gouverneur a catégoriquement refusé - mais d'une mesure destinée à donner toute tranquillité aux banques du groupe anglais.*" (see: B.F., ibid., n.126).

[61] see: B.F., n.126, 12/3/36, pp.102/103.

[62] Quoting the minutes of the Bank of France, "*...il* (Montagu Norman) *envisagerait une somme analogue à celle des plus fortes sorties d'or qui se sont produites en une seule journée, soit 1 milliard environ.*" (B.F., ibid., n.126, p. 102).

[63] Mouré (1991) p.190.

[64] B.F., ibid., n.126

National. As these were rediscounts they were not subject to the ceiling which only applied to direct discounts. However, as the *Crédit National* was a para-statal credit institution this would certainly count as "*avances occultes*."

The government was effectively returning to the policy of the 1920s, viz., monetising items of expenditure falling under the budgetary category of extraordinary expenditure.

The difficulties were compounded by pressure building up against the franc as rumours circulated that the British loan had been used up. This forced a rise in the discount rate from 3.5% to 5%.[65] The increase applied to 30 days bills. The rate charged on funds lent against security of shares (*titres*) was raised from 5% to 6%. The rate on advances on the security of gold and gold coin was maintained,- these operations had already been suspended though. Minutes at the Bank of France record that following these measures and a declaration by the Minister of Finance on 2nd April 1936 the situation improved somewhat. These minutes record that the Bank discounted 500 million francs worth of bills held by the *Crédit National* on 27/3/36 and a further 500 million the next day, presumably this is confirmation of the use of the previously agreed facilities. The Treasury would be entitled to a further 1.5bn. in April. The Bank having agreed to provide 2.5bn. worth of assistance until May (see above).

Further insight into Bank of France policy can be gained from the discussion held over the week of 16-23 April 1936 on whether or not to raise the discount rate following gold losses.[66] It was argued that it would be pointless to raise the discount rate as the portfolio of commercial bills was not increasing and that the problem was caused by advances to the Treasury which were not affected by the rate of interest. In such circumstances a rise in the rate of interest would not stem the gold outflow,- the problem arose from lending to the Treasury.[67]

Two other arguments were adduced against raising rates, viz., that its psychological effect would give the public the impression that the situation had worsened - cf., Nurkse (1944) who argued that a rise in the discount rate in such circumstances would only

[65] B.F., *Délibérations du Conseil Général* 28/3/36, p.147.

[66] see: B.F., n.126.

[67] Quoting the minutes of the Bank of France, "*Un relèvement de nos conditions de crédit serait donc inopérant: il ne saurait empêcher l'or de sortir dans la mesure où nous venons en aide à la Trésorerie.*" (see: B.F., ibid., n.126, p. 175).

precipitate a run - and that it would strengthen the case of those who favoured devaluation on the grounds that it would lead to lower interest rates. The situation was particularly difficult because the first round of parliamentary elections was to be held on 26th April.[68]

However, the 2.5bn. francs which the Bank had agreed to discount was not sufficient, bills discounted now amounted to 3bn. francs, and the Treasury expected to need more before the month was out. These difficulties were partly due to increased defence expenditure. However, the *conseil de régence* of the Bank of France had anticipated that this would probably occur.[69] The Bank had expected that it could well be asked to provide the full amount, some 6bn. francs (see above), by which the discount limit on Treasury bills had been increased. The Bank agreed so long as this would not raise the note issue above the maximum permissible increase in the Treasury bill issue. The bills were to be rediscounted (*avances indirectes*), and not directly discounted, to preserve the fiction that the Bank of France was not providing resources directly to the Treasury.[70]

In a letter to the Minister of Finance, dated 30/4/36, the Governor suggested ways of gradually reducing the number of rediscounted bills held in the Bank of France's portfolio. Governor Tannery suggested that the *Caisse des Dépôts* should absorb them in priority over other investments. The Bank would use funds acquired through Treasury bills placings to reduce the number of rediscounted bills on its books, crediting the funds to its account. The Bank could place the rediscounted bills on the market, particularly as investments for funds deposited by foreign central banks; and any free funds held by the *Caisse d'Amortissement* should be used in priority to reimburse Treasury bills rediscounted.

An entry dated 30/4/36 in the minutes of the Bank of France assessed the advances to the Treasury by the Bank.[71] It records that by the 26/3/36 the Bank had provided the Treasury with some 4bn. francs, through rediscounts of Treasury bills, discount of paper issued by the state railways, and discounts of paper on behalf of the State Bank of Morocco. On top of this, since the 26th of March, the *Conseil* had authorised accommodation of up to 6bn. francs.

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[68] Mayeur (1984) p.349.

[69] see: B.F., ibid., n.126, p.176.

[70] see: B.F., ibid., n.126, 23/4/36.

[71] see: B.F., ibid., n.126, p.186.

Uncertainty concerning the prospects for the francs were underlined in the minutes for 30/4/36 which record that four foreign exchange dealers were taking gold from the Bank of France and exchanging it for gold coins at the Belgian National Bank. The coins would then be sold to domestic French resident hoarders (who otherwise could only acquire ingots worth 215,000 francs). Apparently the same operation had been conducted with Switzerland. The quantities involved amounted to 43 million and 32 million francs respectively. The Governor suggested pressure on these dealers by threatening to close their accounts at the Bank of France.

By the 6th May the Bank was convinced that it would have to raise the discount rate, as it faced increased gold exports, though it knew it would have no effect. It was important though to show foreigners that the Bank was not indifferent. It was argued that a rise in the discount rate would be ineffective as the source of the problem was Treasury borrowing, and a rise in the discount rate would make no difference. The other reason was a technical one: the money supply had expanded and the Bank was no longer in touch with the market.[72] The minutes point out that in the previous two months the gold stock had fallen by 6.2bn. francs[73] but credits granted had risen by 7.2bn. This was quite the reverse of what should have happened under a gold currency standard.[74] The discount rate was raised from 5% to 6%, and the loan rate on collateral securities was raised from 2% to 8% to discourage these operations. The rate for advances on the security of gold and gold coin was raised from 7% to 9%.

[72] This rather contradicts the Bank's oft-repeated rejection of open-market policies (see chapter ten on the open-market policy debate) on the grounds that the Bank of France through its substantial branch discounting network kept in close touch with the credit market. Of course this might well have been a sound argument if it only discounted "real" commercial bills, however the problem was caused by Treasury recourse to effectively non self-liquidating Treasury bills. Without the ability to sell government debt in the money market the Bank found it hard to control a market awash with short-term liquidity. One could argue that the Bank could raise interest rates sufficiently to make new treasury bills attractive, but in practice in cases of extreme financial uncertainty overnight money market rates would have to be astronomical (on an annualised basis) to compensate for a potential devaluation and such high rates would only point to the untenability of the situation. The fundamental error, of course, with regard to open-market operations was the relatively passive role left to the Bank, viz., controlling demand for credit through the discount rate. The British view was that open-market operations could serve as a mechanism to forcefully inject/extract liquidity in/from the system and thereby better control credit conditions.

[73] see: B.F., ibid., n.126, p.195.

[74] This is why Hayek would argue that the gold standard had lost much of its automaticity with the concentration of gold in the vaults of central banks.

The Bank was under no illusions that virtually none of the Treasury bills which it rediscounted on behalf of banks were to finance commercial activities, but that the banks were simply acting as intermediaries between the Treasury and the Bank. This intermediation intended to provide *de jure* conformity with the Bank of France's statutes which forbade direct advances to the Treasury under the monetary law of June 1928.[75]

In order to regularise the situation and to underline the fact that the Bank did provide assistance it was suggested that a special account be opened and that the government guarantee losses in case of devaluation until the next government regularised the situation by legislation allowing advances to government. This motion was proposed by the College of Censors. The Governor of the Bank agreed in principle, but deferred the decision until the new government came to power and passed the required legislation, as any action ahead of the elections might be misinterpreted.[76]

These minutes also make it apparent that the Treasury was in need of a further 3bn. francs until the next meeting of parliament on 1/6/36. The 6bn. francs accommodation had already been fully taken up. The Treasury could still count on a margin of 1.5bn. as that amount had been used to redeem existing bills. It therefore needed a further 1.5bn. This margin could be found upon recalculation (!) of outstanding Treasury bills. It was found that the number issued so far was only 19.7bn. against an upper limit of 21.2bn. francs, this was undoubtedly because of the previously redeemed 1.5bn. worth of bills (see above). The Governor let his reservations be known. However, he agreed on condition that the facility be supported by a written request from the Minister of Finance. The Bank agreed to the 1.5bn. needed to the end of May, but insisted that the funds needed for the first two weeks following the return of parliament should be negotiated with the new government and that the Bank reveal the situation to the incoming government.[77] Eichengreen illustrates the government's treasury difficulties, pointing out that, "In the first half of 1936, the Bank of

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[75] Quoting the original minutes of the Bank of France, "*Il est hors de discussion que pour la presque totalité les Bons du Trésor présentés à la Banque et acceptés par elle n'ont point le caractère de concours aux besoins réels et effectifs des Maisons qui les présentent, mais qu'en réalité ces Maisons jouent simplement le rôle d'intermédiaire entre le Trésor et la Banque aux fins de signatures exigées par Celle-ci, les avances directes au Trésor, c'est-à-dire à l'Etat, ne pouvant plus être faites depuis la loi monétaire de Juin 1928.*" (see: B.F., ibid., n.126, 22/5/36, p.237).

[76] see: B.F., ibid., n.126, 22/5/36.

[77] see: B.F., ibid., n.126, 22/5/36, p.240.

France discounted perhaps two-thirds of all newly issued treasury bills."[78]

The minutes of the Bank record a meeting between Governor Tannery and the future Finance Minister Auriol 4/6/36. It was decided that discounts of Treasury bills would be increased a further 1.5bn. as a second recalculation had shown that the maximum limit on treasury bills was not 21.2 billion, but 22.7bn.! This procedure was agreed on 5/6/36. On the 6/6/36 Tannery (appted. Governor 3/1/35) was dismissed by the incoming Popular Front government and succeeded by de Labyerie. Tannery's farewell address stated that the Bank under his stewardship had managed to preserve the exchange parity of the franc and had been given the fullest technical assistance by foreign central banks in so doing.[79]

The minutes of the Bank for 11th June point to the difficult exchange situation which the Popular Front had inherited. The report indicates that by the 5th June gold exports since the last statement had reached 1.5bn. francs[80] and that from the beginning of the year to the 10th June total gold exports had reached 11,345bn. francs, i.e., the Popular Front had inherited what amounted to a foreign exchange crisis. This was on top of the existing budgetary, and treasury (i.e., difficulties of financing the deficit) crises. The three crises perversely interacted.

The minutes record that measures taken to prevent internal gold hoarding seemed to have met with success and it was suggested that it be agreed with the BIS that gold coins would not be put back into circulation once they had been deposited. It was clear that there was a *de facto* drift towards using gold as a means of settling official international balances, i.e., a gold bullion standard.

The assessment of the situation revealed that in the year to 5th June the amount of government and treasury paper (*effets publics*) discounted amounted to 13bn. francs. In the previous year total discount had only reached 7,736bn. of which 5,159bn. was commercial paper.[81] It concluded that the increase in discounts was almost solely due to discounts of

[78] Golden Fetters, p.372.

[79] see: B.F., ibid., n.126 pp.267-268.

[80] see: B.F., p.277.

[81] B.F., ibid., p.279.

government paper.[82] However, the minutes also record that the gold cover still stood at 59.68% of sight liabilities. This of course had always been an essential part of the problem.

France's substantial gold reserves had bred the illusion that any drain on the exchanges or balance of payments shortfall could be financed. The real problem lay though in the deflationary macro-economic stance imposed by the high fixed exchange rate. In order to avoid importing deflation the authorities were increasingly pushed into protectionism which prevented adjustment in any case (see Reynaud). Hodson writing for the 1936 Chatham House Survey of International Affairs concluded, "that the advantages of relief from currency over-valuation lay less in the rectifying of adverse balances of trade than in the ending of deflationary strains upon the internal commercial and credit system,"[83] a case which has recently been brilliantly argued by Eichengreen.[84] The fact that the government was unable to balance the budget and increasingly had to monetise its deficit might be considered a blessing in disguise as this ensured a degree of involuntary contra-cyclical easing of policy, though such liquid funds were more likely to lead to capital flight and substantial gold outflows in times of crisis, and therefore higher interest rates as the financially orthodox would counter.

Auriol, the new Finance Minister, had inherited an unenviable situation. Although some of the Treasury difficulties and currency weakness can certainly be ascribed to the prospects of a Popular Front government. However, the underlying fiscal crisis had been growing under various governments since the onset of the depression. And the policy of "*avances occultes*," increasingly supplanted by renewed direct discounts on Treasury account, had begun in a significant way under preceding governments. Hodson pointed out that devaluation would form a logical concomitant to the Popular Front programme.[85] However, it followed a compromise policy which precluded devaluation because of communist opposition in particular, though the radicals were none too keen either. The radicals would have found exchange controls anathema. Blum was to stress the essence of the "Blum

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[82] Quoting the minutes of the Bank, "*...c'est aux présentations d'effets publics qu'est presque exclusivement due l'augmentation qu'il a subie depuis lors.*" (B.F., n.126, p.279).

[83] see: Survey of International Affairs (1935) p.198.

[84] see Golden Fetters.

[85] see: Survey of International Affairs (1936).

experiment" was that it was conducted within bourgeois political and economic institutions and parameters.[86]

Blum in presenting his policy to parliament on 6th June rejected devaluation, for which he was criticised by erstwhile staunch defenders of the franc, such as Charles Rist and Joseph Caillaux.[87] Both argued that existing policies would mean that the French economy would become increasingly hemmed in by controls. Mouré argues that the banking establishment and financial experts came around to the view that devaluation was preferable to exchange controls.[88] Caillaux advocated an international stabilisation agreement and some form of compulsory debt conversion. Even Germain-Martin had swung round and now supported a two-tier exchange system. According to such a scheme whilst there would be no modification, "in the legal gold definition of the franc, the Government should seek parliamentary authority for controlling foreign exchange rates through the concentration of international monetary business in the hands of a small body of experts, whose immediate task would be to fix the pound sterling at about 100 francs, and the dollar at 20 francs, and hold them there. The rates actually ruling at the time were about 75 francs for the pound and 15 francs for the dollar."[89] This policy could only have been realised though through the use of exchange controls,- a radical departure from Germain-Martin's avowed economic liberalism. However, the government rejected this option and Auriol was immediately confronted with the Treasury difficulties and the problem of regularising the existing situation with the Bank. One should note however that Blum did not reject "stabilisation" if part of an internationally negotiated agreement.[90]

In a letter dated 9/6/36 Auriol made clear to the Bank that he was unwilling to fall into the trap of placing advances to the government under a special heading at the Bank. In a similar situation in the 1920s de Wendel had insisted that special advances be placed under

[86] see: Senate devaluation debate, 28/9/36-1/10/36, in, *Journal Officiel, Débats, Sénat.*

[87] see: Hodson, Survey of International Affairs, p.165.

[88] Mouré (1991) p.241.

[89] see: Hodson, ibid., p.165. For Germain-Martin's *volte-face* in favour of some degree of exchange control see also Mouré (1991) p.240.

[90] Quoting Drummond (1981), "In the Senate on June 16 Blum said that no one contemplates devaluation except as part of international arrangements... and of a contractual and general alignment." p.200.

a special heading thereby killing the measure, as we have seen he did so again in 1935 under Flandin. Auriol refused to take action until his mind had been made up about what course to take to stem the crisis. The *conseil de régence* of the Bank noted that they had no choice, but to accept the situation. However, the "*conseil*" still supported a regularisation of the situation. On the 15th the minutes of the Bank record that the government had asked for a discount of 750 million francs worth of bills promising that this would be the last time![91] Bassot speaking on behalf of the *collège de censure* pointed out that if the Bank was to make advances to the State, which should only occur under exceptional circumstances, this would need legal sanction.[92] And in such a case the Bank should be consulted. It is clear that the Bank had no inkling of the sea change in relations between the government and the Bank which was about to take place. In the UK Montagu Norman had quickly realised that with the loss of control of the exchange rate to the Exchange Equalisation Account, in 1932, the Bank of England had lost most of its effective influence.[93]

In the ensuing discussion, within the *conseil de régence*, both Duchemin and de Rothschild pointed out that the Bank could not allow the government to go bankrupt.[94]

On June 18th Auriol asked the Bank for a credit of 10bn. francs. It was supposed that this would be enough to cover the Treasury's needs through 1936. According to the proposed "*Convention*" with the Bank, the Bank would also advance up to 14bn. francs to the Treasury without interest, except a 0.2% annual commission on the outstanding loan. These funds would be used to reimburse Treasury bills and paper issued by public sector entities (*collectivités publiques*) which were to fall due and had been discounted by the Bank. These discounts would appear under a special heading in the Bank's balance sheet, headed "*avances temporaires à l'Etat.*"[95] In other words the government plan for "regularising"

[91] see: B.F., ibid., n.126, p.292.

[92] Bassot speaking on behalf of the Collège de Censure of the Bank of France, "*... il s'agit de savoir sous quelle forme la Banque de France consentira des avances à l'Etat. C'est là une opération qu'elle ne peut faire que si une loi l'y autorise expressément, dans des circonstances exceptionnelles. Encore conviendrait-il que la Banque fut appellée à donner son avis sur les conditions de cette dérogation à ses status.*" (see: B.F., ibid., n.126, pp.292-293).

[93] q.v., the surrender of British exchange rate policy to the Bundesbank in 1990.

[94] see: B.F., ibid., n.126.

[95] see Mouré (1991) p.188.

the situation amounted simply to recognising the indefinite monetisation of treasury bills previously discounted! As was subsequently recognised,[96] the government had at least had the courage to regularise the situation rather than continue relying on expedients as the preceding governments had done,- of course it had little choice. As a counterpart to the 10bn. francs which the Bank would lend to the Treasury the Bank would receive three month Treasury bills bearing no interest, renewable until paid off. Moreau would clearly have blanched at this (cf., his Memoirs). In practice this was like accepting unredeemable zero coupon consols/bonds! Article six of the *Convention* stipulated that these advances would not be considered productive and therefore not subject to tax[97] - were the proceeds included in the figure for the note circulation? The potential total net increase in note circulation was 10bn. out of total sight liabilities of 92,808 million (with gold cover at 58.79%). Sight liabilities would therefore be increased 11%. To accommodate this the Treasury bill ceiling was raised to FRF 20bn. (of which only FRF 10bn. had been issued)[98],- this figure must exclude bills issued under the provision of the "*fonds d'outillages et d'armement.*" (see above).

The new Governor of the Bank, de Labeyrie, was also loosening credit policy. He reduced the discount rate and the rate charged on lending against collateral securities (*avances sur titres*). De Wendel, a politically prominent regent of the Bank of France (he was one of the leaders of the *Fédération Républicaine*), found this worrying in case the Bank should soon have to raise rates. However, the government wanted lower rates in order to float a loan.[99] The minutes of the *conseil* meeting on 16/7/36 record that it had now been a year since any new loans had been made on gold ingots or coin.[100] These had been suspended to stem speculation.

On the 24th July legislation was introduced altering the statutes of the Bank of France and the regents were dismissed. At the last meeting of the *conseil de régence* the doyen of the body, Mallet, speaking on behalf of the regents, launched a blistering attack on the

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[96] see devaluation debate in the Senate September/October 1936, in, *Journaux Officiels*.

[97] see: B.F., n.126., pp.304-305.

[98] see Mouré (1991) p.188.

[99] see: B.F., ibid., n.126, 9/7/36, p.368.

[100] see: ibid., p.375.

government.[101] Governor de Labeyrie was obliged to ask the regents not to publicise this statement, without success. Mallet bitterly attacked the notion that the regents of the Bank represented a special self-serving vested interest group, a notion encapsulated in Daladier's populist denunciation of the "*200 familles*" or the earlier "*mur d'argent.*"[102] Mallet claimed that the Bank's credit policy had always been impartial and not confined to certain privileged groups. The *conseil général* had always acted to protect the franc, whilst taking into account the interests of trade and commerce. Responding to the criticism that the Bank had accommodated government by discounting government paper, Mallet answered that the *conseil* had resigned itself to this in the public interest. This policy had been a response to the re-occupation of the Rhineland, when national defence needs were the predominant consideration and funds had been needed to see the government through to the elections. In the circumstances, the *conseil* had felt that refusal to make such advances would have been improper. The Popular Front could hardly accuse the Bank of partiality as it had offered it similar facilities during the month of June.

Mallet then proceeded to attack the government for disenfranchising the shareholders' representatives, viz., the regents of the Bank. Furthermore, the new legislation would replace shareholder representatives by appointees representing user interests with the consequences, viz., inflation, that one could expect. In such circumstances the concern for defending the franc could conflict with the interests which they represented. Mallet argued that the expectations which had been created would lead to a policy which confused credit and subsidies and that this constituted a considerable threat for the future.[103] Labeyrie's

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[101] see: B.F., ibid.,n.126 pp. 389-391.

[102] see Jeanneney (1976).

[103] Quoting Mallet's speech in extenso, "*En ce qui concerne la répartition du crédit, nous pouvons affirmer, sans crainte d'être contredits, que le Conseil Général a toujours fait preuve d'une complète impartialité et que, contrairement à des assertions mensongères, loin de réserver les facilités d'escompte à quelques priviligiés, il en a au contraire fait largement bénéficier les moyens et petits commerçants, industriels et agriculteurs qui entrent dans les opérations de l'espèce pour plus de 75%.*

"*Quant à la défense du franc, elle a fait notre constant souci et, gardien des principes de la saine monnaie, le Conseil Général n'a jamais rien négligée pour l'assurer tout en s'efforçant de concilier les mesures à prendre en ce domaine avec les besoins vitaux du commerce, de l'industrie et de l'agriculture.*

"*Néanmoins, nous avons été critiqués pour avoir, sous l'influence de préoccupations politiques, approuvé d'importantes avances à l'Etat, par voie d'escompte de bons du Trésor.*

"*Le Conseil s'en est en réalité résigné à accorder ces avances pour des motifs entièrement étrangers à de telles préoccupations et prises dans la considération exclusive de l'intérêt général. Pour la part de beaucoup la plus forte, elles lui ont été demandées d'abord au lendemain de la réoccupation de la Rhénanie,* welcoming speech to the new governing board, renamed the *conseil général*,[104] of the Bank

en vue de faire face à de très urgents besoins concernant la défense nationale, ensuite pour permettre d'assurer le paiement des dépenses publiques pendant toute la periode des élections. En présence des difficultés particulièrement graves que rencontrait dans ces circonstances la collectivité nationale, le Conseil Général n'a pas cru devoir opposer au Gouvernement de l'époque un refus qui eut entraîné la fermeture des caisses publiques. Le Gouvernement d'aujourd'hui est d'autant moins fondé à lui reprocher cette attitude et à la taxer de partialité politique que pour assurer le fonctionnement des administrations et services durant le mois de Juin, il a sollicité l'octroi des mêmes facilités, qui lui ont été accordées sans hésitation pour les mêmes considérations d'intérêt général.

"Après cet exposé qui concerne le passé, nous ne pouvons pas nous dispenser d'exprimer ici nos inquiétudes pour l'avenir.

"La nouvelle législation qui régit la Banque élimine presque totalement du Conseil la représentation des actionnaires. A une époque où la défense de l'épargne est à l'ordre du jour, il est difficile d'admettre que les 41,000 actionnaires de la Banque de France soient ainsi dépossédés de leurs droits, alors que la loi a désigné les actions de la Banque comme un placement autorisé pour les mineurs, les interdits et les femmes dotales dont elle a voulu assurer la protection.

"On peut ajouter que la loi, en portant atteinte aux droits des actionnaires, risque de compromettre du même coup l'intérêt général. Elle substitue en effet, dans le Conseil, aux mandataires de ceux-ci, des représentants des usagers, des demandeurs de crédit dont les préoccupations seront toutes normalement orientées dans le même sens, et pour lesquels le souci de défendre la monnaie pourra se trouver en conflit avec les besoins des entités qu'ils représentent.

"Nous envisageons donc les temps qui viennent avec une grande appréhension.

"Les espérances d'une manne généreuse distribuée à tous venants par la Banque de France, la confusion entre le crédit et la subvention, l'équivoque des promesses irréalisables, constituent pour l'avenir une menace redoutable.

"Dans l'intérêt du Pays, nous souhaitons ardemment que la nouvelle direction de la Banque réusisse à ne pas être submergée par le flot des revendications des parties prenantes, et que du tumulte actuel il sorte le moins de mal possible pour notre monnaie et pour l'économie." (see: B.F., n.126, pp.389-391). The government had requested that this address not be released. It was released and precipitated a spirited rejoinder, and defence of his policies, from Auriol. This was published in an open-letter addressed to Mallet. It is reproduced in Dauphin-Meunier (1937, pp.224-226) *in extenso*.

Quoting extracts, *"Vous n'ignorez pas que, sauf les 200 plus forts actionnaires, dont vous êtes vos collègues et vous et qui sont exclusivement les représentants ou les administrateurs de grandes sociétés financières et industrielles, les 41,000 actionnaires n'ont aucun droit, ni celui d'élire les régents et les censeurs, ni même celui d'approuver les comptes rendus ou de présenter des objections.*

Ils ne sont que de simples de bailleurs de fonds, qui n'ont ni influence, ni possibilité de contrôle, ni droit de décision.

C'est ce contrôle effectif, c'est le droit d'être personnellement informé de la gestion de la Banque et d'élire les censeurs et des administrateurs que, pour la première fois depuis 150 ans, la loi républicaine vient de donner à tous les actionnaires sans distinction et par là-même, aux représentants des mineurs, des interdits, des femmes dotales.

Donc, prétendre que nous dépossédons les actionnaires et que nous manquons au devoir de protection de l'épargne, c'est un jugement sommaire qui surprendra l'opinion publique, et c'est surtout, une étrange manière de défendre les actions, alors que nous nous sommes préoccupés d'éviter toute spéculation et de régulariser les cours.

Il est vraiment regrettable que des hommes chargés d'une haute responsabilité aient laissé leur amertume dominer le souci des intérêts dont ils avaient la charge...

Ici encore, c'est une étrange façon de défendre la monnaie et de ranimer le marché que de jeter dans le public des jugements aussi sommaires et aussi peu justifiés étant donnée, surtout, l'autorité qui s'attache à vos hautes fonctions."

[104] Its former name, viz., *Conseil de Régence* obviously, smacked too much of the *ancien régime* as did the names of some of the banking families which sat at its table.

adopted an entirely different tone.[105] He argued that the "primary objective must be the protection of the nation by ensuring bread and labour for the people." Such a statement would never have been heard within the confines of the old *conseil* (*de régence*) of the Bank. Labyerie went on to state that the Bank would occasionally have to provide the Treasury with the means which taxes and borrowing could not momentarily furnish. This had been traditionally the role of the Treasury (previously known as the *Mouvement Général des Fonds*). It is important to note that making the Bank rather than the Treasury (*Trésor*) responsible for government "ways and means advances" clearly indicates that the government aimed at financing the shortfalls by printing money rather than borrowing. Labeyrie added that it was better that those making the decisions were politically accountable. Labeyrie suggested that this would act as a stronger restraint than the Bank acting independently.[106]

This was followed shortly afterwards, on July 24th 1936, by a reform of the statutes of the Bank of France. The "*Conseil des Régents*," which had been elected by the Bank's 200 largest shareholders since Napoleon's day, was abolished. From now on all the shareholders were allowed to vote, but they could elect only one representative! In effect, though various interest groups could now put forward candidates to sit as members of the *Conseil Général* so could the government, as a result the balance of power within the Bank was firmly in the hands of the government. The Bank, though nominally still a private institution, was now, to all intents and purposes, a public institution. However, one should note that, ever since 1803 the Governor of the Bank of France and his two deputies had been

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[105] It is worth quoting extracts from de Labeyrie's welcoming address to the new Bank board as it provides such a striking contrast to Mallet's firmly expressed views (*vide supra*). "*Que pèse l'expérience technique des Banques Centrales et l'énergie de leurs dirigeants devant la nécessité vitale de sauvegarder l'intégrité du territoire national et d'assurer aux hommes du travail et du pain?*

"*Sans doute, dans les heures de crise, l'Etat est-il parfois conduit à demander à la Banque, pour les répandre dans l'économie, les ressources que ne peuvent, momentanément lui procurer l'impôt ni l'emprunt, mais la nécessité de limiter ces demandes à des montants déterminés et de les justifier devant l'opinion, constitue un frein dont ne disposerait pas l'institut d'émission s'il lui fallait intervenir lui-même directement.*" (see: B.F., n.127, p.3). Labeyrie's address appears to have been made end-August or at the very beginning of September 1936.

[106] The question of political accountability of course finds resonance in the UK debate over whether to give an independent status to the Bank of England which is a legitimate political question. However, the argument that political accountability would produce a more responsible conduct of monetary policy is hard to accept most would agree that the whole point of having the central bank under Treasury control is that this does allow the government greater policy autonomy (at least in the short-term), whilst making the government ultimately politically accountable before the electorate for its actions.

government appointees.[107] The Bank of France had therefore always been more a creature of government than the Bank of England.

The Governor of the Bank of England was appointed from within the Court of Directors, which largely represented City merchant banks. This is not to say that the Bank of England did not maintain very close relations with the Treasury.

Under the new legislation the Bank of France was also forced to discount, "all short-term liabilities of the Treasury which were within 3 months of maturity."[108] This arrangement had been arrived at on an informal basis in June 1936 when the government found it impossible to borrow.

The Bank's lending policies were soon to be further relaxed and on 6/8/36 it was agreed that bonds issued by the regional railway companies would be suitable collateral for advances at 80% of their face value. The bonds had been issued in February by, "*Les Compagnies de Chemins de Fer de l'Est, du P.O., du P.L.M., du Midi, du Nord, et les Administrations des Chemins de Fer d'Alsace-Lorraine et de l'Etat.*"[109] The railways which were subsidised would soon be nationalised, making their paper eligible as collateral for loans would increase its liquidity and acceptability.

On coming to office the Popular Front found the discount rate at 6% and the Bank's loan rate at 8%. These high rates had been introduced by the previous government to defend the franc. By July 9th these rates had been reduced to 3% and 4% respectively.[110] In a statement on 19th June Auriol had painted a bleak picture of the situation which the government had inherited. The Bank had rediscounted 14bn. francs worth of treasury bills and total Treasury bills discounted stood at 21.9 billion francs against a sanctioned limit of 22.8bn.[111] Auriol estimated the budget deficit for 1936 at 7bn. francs and Treasury needs for 1936 at 10bn. francs.[112] The 10bn. francs needed were broken down in the following

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[107] see Ramon (1929).

[108] Wolfe (1951) p.166.

[109] see: B.F., n.126, p.402.

[110] see: Survey of International Affairs.

[111] see: Survey of International Affairs (1936) p.170.

[112] Source: *ibid.*.

way: 2bn. francs to cover the budget deficit; 5bn. to fund national defense; and 3bn. to redeem the loan contracted with the British banking consortium in February 1935.

Auriol rejected the idea of a capital levy (undoubtedly because of radical opposition). Immediate measures included the extension to 15th July of the deadline for the compulsory declaration of capital held abroad, with severe penalties for non-declaration. This would have caused a shudder in financial markets as it was obviously a possible precursor to exchange controls. To cover its Treasury needs the government requested a 10bn. franc credit line from the Bank (see above). This would be drawn if funds raised through the issue of Auriol bonds proved insufficient. These bonds were deliberately issued in small denominations, hence the expression "baby bonds", in order to appeal to small savers.[113] Denominations ranged from 200 to 100,000 francs. The issue was launched on 10th July. Maturities were for six months and a year, with interest at 3.5% and 4% respectively. The Survey of International Affairs pointed out that despite relatively high yields, e.g., compared to UK rates under 1% on short dated paper the issue was not a success, underlying the degree of uncertainty then prevailing. By the 4th August only 2.3bn. francs had been raised, the issue was suspended on 23rd September having raised only 4bn. francs.

Despite the peaceful resolution of the sit-in strikes with what appeared to be substantial concessions on wages and conditions of employment under the Matignon agreements capital had taken fright and a gold haemorrhage set-in. The gold reserve fell from 54bn. on 18th June, to 50.1bn. on 25th September 1936. This was too close to the minimum 50bn. war chest which had been a rule-of-thumb since Pallain's day, as Governor.[114]

Ahead of devaluation the government was being drawn dangerously close to introducing exchange controls. "An Act of the 13th August, 1936, obliged banks and financial concerns to disclose particulars of all securities, not acquired in trading on the bourse, exported by them or through them since the beginning of 1934, and a demand to this effect was circulated on the 2nd September. This requisition was additional to the law compelling citizens to declare what capital they held abroad at the 31st December, 1935

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[113] see: Survey of International Affairs (1936) p.171.

[114] For tables illustrating the decline in Bank of France gold and foreign exchange reserves see Eichengreen (1992) tables 10:7; 12:3; and 12:5.

(property acquired in the course of 1936 need not be disclosed till the end of the year)," and, "Restrictions were placed on the purchase of foreign bank notes; the sale of gold coin was virtually prohibited; and travellers from France were obliged to declare any gold or precious metals that they were taking from the country. Heavy punishment was provided for any one who knowingly spread rumours calculated directly or indirectly to shake the confidence of the public in the soundness of the currency, or who incited to the withdrawal of deposits or the sale of government securities."[115] However, the franc continued to weaken.

The international situation was worsening and there was uncertainty as to whether the Popular Front would hold together on the question of intervention in Spain. On top of this increased wage costs seemed to make devaluation inevitable and the government's fiscal situation worsened. Jackson (1985) argued that, "...it was the announcement by the Blum government of a 14mF. (bn) programme of rearmament in September 1936 which precipitated the financial crisis that preceded devaluation."[116]

Hodson in his article in the Survey of International Affairs points out that raising the discount rate on 24th September merely served to further undermine confidence by underlining how desperate the situation had become.[117] "The raising of the rate was regarded as a sign, not of strength, but of weakness, all the more because it represented a complete reversal of the French Government's previous policy of cheap credit, which was an essential part of M. Blum's economic programme."[118] And the forward discount against the franc widened. On the 25-26th the gold standard was suspended and gold exports were prohibited on 28th September.[119]

The minutes of the Bank of France indicate that gold reserves had fallen by 4.4bn. francs in a four week period prior to devaluation, viz., from 54.5 billion francs to 50.1 billion over the period from the 28th August to 25 September.[120] The minutes of the Bank

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[115] see: Survey of International Affairs (1936) p.173.

[116] Jackson (1985) p.207.

[117] Survey of International Affairs (1936) p.174.

[118] Survey of International Affairs (1936) p.174.

[119] Sédillot (1953) p.300.

[120] see: B.F., n.127, 1/10/36.

indicate the following destinations for gold exports, UK 807m.; Spain 361m.; US 2,950m.; the Netherlands 227m.; Switzerland 224m.; Yugoslavia 40m.; and the BIS 158m. However, the gold cover still stood at 54.42% having dropped from 58.69%. The minimum gold reserve ratio as a proportion of sight liabilities had been fixed at 35% by the Monetary Law of 28th June.[121] On the 25th September gold exports had amounted to 1,126 million francs. The Bank attributed this to the action of domestic residents and noted that the US banks had acted perfectly properly.[122]

In chapter eight we saw how the devaluation was presented as part of an international re-alignment. Here we shall briefly examine the technical modalities of the devaluation and the parliamentary debate on devaluation, as it sheds significant light on the sort of constraints within which the Popular Front was operating.

The new monetary law of 1st October 1936 fixed the franc's gold parity between a maximum of 49 milligrams and 43 milligrams at 9/10th fine. This amounted to a potential devaluation range of 25.19% to 34.35% against its former Poincaré gold parity. The principal feature to note here was the revaluation of the Bank of France's gold reserve at the new maximum gold parity of the franc. The profits realised were credited to the Treasury. The revalued gold stock yielded profits of 17bn. francs and 17.3bn. if foreign exchange and foreign paper were included. For accounting reasons disposable profits amounted to 16bn. francs of which 10bn. would be credited to an exchange equalisation fund, 4.5bn. towards clearing the account of Treasury advances held at the Bank of France, the remaining 1.5 billion to the state as provisional advances without interest.[123]

However, it is clear that the Bank considered this valuation as provisional and expected that a more permanent settlement could well lead to a further revaluation of the gold reserve, i.e., devaluation of the franc. The minutes of the Bank clearly suggest this and indicate that a further revaluation of the gold reserves at the minimum parity,[124] which would occur as part of a process of setting a definite parity for the franc, could yield a

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[121] see Pirou (1938) p.68.

[122] Quoting the minutes of the Bank, "*...les sorties d'or sont dues, pour la plus grosse part, à des opérations faites sur le marché français et que les banques américaines ont agi avec une parfaite correction.*" (B.F., n.127, p.46).

[123] see: B.F., n.127, 5/11/36, p.96.

[124] see: B.F., n.127, 25/9/36.

further 10bn. francs, i.e., a total windfall gain of 26bn. francs.[125] At this meeting it was decided that the discount rate would soon be reduced from 5% to 3% as well as the rate charged on borrowing against securities' collateral. On the 2nd October the Bank reduced the discount rate to 3%, to 2.5% on the 8th, and 2% on the 15th. This cannot have encouraged financial markets. In the UK, following devaluation, the bank rate had been raised to 6.5% signalling the authorities' firm commitment to defend sterling. The contingency against which Reynaud had been warning since 28th June 1934 had occurred, viz., a devaluation "*à chaud.*" The budget remained unbalanced and the authorities were slashing the discount rate, though the treasury position *vis-à-vis* the Bank had temporarily improved. Sédillot gives a figure of 12.3bn. for the level of outstanding advances from the Bank to the Treasury after the devaluation,[126] however this was the product of the transfer of profits realised on gold reserves from the Bank to the Treasury and was wholly cosmetic.

Before taking the account of the French monetary debacle to its close in 1938 when the franc was pegged to sterling, it is worth examining the parliamentary debate on the devaluation bill.

THE DEVALUATION DEBATE IN PARLIAMENT (28/9-1/10/36):

The devaluation bill as originally voted in the Chamber of Deputies included a wage indexation clause in part to satisfy the communists. The communists, who supported the Blum government had been constant opponents of devaluation on the grounds that it would result in higher prices and erosion of real wages. The indexation clause also enjoyed some socialist support,[127] though the radicals were not keen on wage-indexation.[128]

In the Chamber of Deputies, Jammy Schmidt, *rapporteur* of the Finance Committee,

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[125] Quoting the minutes of the Bank on profits which could be realised on a further revaluation of the Bank's gold reserves at its minimum Auriol gold parity, "*A la suite de la révaluation complémentaire qui serait éventuellement effectuée après la fixation définitive de la teneur en or du franc, le total de la plus-value pourrait atteindre - sur la base de 43 milligrammes d'or au titre de 900 millièmes, et en supposant que les éléments d'actif à réévaluer n'auraient pas varié entre-temps - une somme de 26 milliards.*" (see: B.F., n.127, 25/9/36, p.46).

[126] Sédillot (1953) p.304.

[127] see: <u>The Times</u> 2/10/36, in, M.F., B 32 325.

[128] see: <u>Bulletin of International News</u>, July 1936 to June 1937, p.5.

pointed out that he had supported devaluation for some while, that the government had always sought to achieve this within an international context, and that the Tripartite Agreement provided the necessary framework. In defence of measures to control prices he alluded to the Belgian experience where the government had acted by Royal decree to mitigate price rises.

However, Pierre Colomb derided the idea that the Tripartite Agreement constituted an international agreement tellingly pointing out that each of the three governments had issued its own separate declaration. Colomb reminded the assembly of Blum's originally stated policy objective, viz., that the government's financial programme would be based on the nation opening a substantial credit to itself and by this means obtain the results which other countries had achieved through devaluation.[129] Colomb also quoted Blum's pledge of 6/6/36 not to devalue and added that Auriol had made a similar statement on 19/6/36, although he now admitted that the government had begun negotiations with the UK and US on 6/7/36. Colomb attacked Auriol for the subterfuge practised on subscribers to "Auriol bonds."

The attack against the government's devaluation bill was pursued by Louis Marin, head of the *Fédération Républicaine*, who pointed out that during the election campaign the radicals, who formed part of the Popular Front, had opposed devaluation. It was also known that the communists had opposed it. Their abstention in the previous day's vote (to suspend the gold standard) confirmed this. Marin pointed out that the conditions accompanying devaluation under Poincaré had been radically different. Poincaré had led a government of national unity. Marin also spoke out against lifting agricultural protection. Later in the debate F.Grot would argue that dismantling quotas would only widen the trade deficit.

However, criticism directed at the government's bill by Georges Bonnet, a radical and erstwhile Finance Minister, was far more awkward for the government. Bonnet began his speech by stressing the fact that radical governments, Herriot's and those which had followed, had pursued deflationary policies, rather than devalue, at considerable electoral cost. In Auriol's defence, Bonnet stated his belief that Auriol had been sincere when he had

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[129] The following is Pierre Colomb's quotation of Blum's policy statement made on 6/6/36, "*Le Gouvernement n'a pas été touché de la grâce. Le fond de sa politique financière sera d'essayer, par un large crédit que le Gouvernement s'ouvrira à lui-même, d'obtenir le résultat que la dévaluation a procuré à d'autres pays.*"

condemned devaluation. Bonnet, who was well placed to know as he had been Finance Minister at the time, pointed out that the UK had not altered its stance since the London Conference,- this could be construed as an implicit indictment of the Tripartite Agreement.

Bonnet went on to condemn devaluation as an infringement of contractual relations (though, if anything, Laval's deflation by decree constituted a far more arbitrary intrusion in contractual relations). He argued that devaluation would affect small-savers, which the radicals represented. Bonnet pointed out that in Belgium devaluation had been accompanied by economy measures. However, the French government had included measures which would raise expenditure, in an environment in which prices were already rising. Bonnet argued that devaluation to be successful needed to be accompanied by a reflux of capital, only then could interest rates be lowered and the debt converted. Bonnet stated that the advantage to be derived from a devaluation was that costs, e.g., wages, adjusted with a lag. Wage indexation, however, would cause prices to rise defeating the object of devaluation. Furthermore, indexation would lead to an arbitrary redistribution of income from which *rentiers* would not benefit.

Reynaud for his part refrained from gloating, but pointed out that devaluation did not constitute a policy in itself, but rather a precondition for a policy. The government should accompany devaluation with measures to balance the budget, or at least an attempt to do so. Reynaud pointed out that Blum's earlier policy of neither deflation nor devaluation, which aimed at raising consumer purchasing power, stimulating production and thereby lowering unit costs, had failed and had only succeeded in raising retail prices.[130] In his defence Auriol argued that his government had inherited an awful position and a very substantial

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[130] It is useful to quote Reynaud's reminder of Blum's policy statement made in November 1935. Blum had been prompted into articulating his economic policy programme to demonstrate that he did have a policy alternative, "*Pardon? Nous avons une doctrine qui s'exprime dans une formule simple et claire : "Ni déflation, ni inflation." Et comme nous ne méconnaissons pas qu'il y ait un problème des prix, comme vous avez raison d'affirmer que les prix français sont trop élevés par rapport aux prix mondiaux, nous avons notre formulle personnelle pour résoudre ce problème. Cette formule consiste à augmenter le pouvoir d'achat des masses et à activer ainsi la production industrielle. Celle-ci étant accrue, le prix de revient unitaire doit diminuer.*" (see: *Chambre des Députés, Débats*, 28-30/9/36, p.2772).

This declaration by Blum in 1935 is of some interest. Jackson (1985) argued that the Popular Front programme had been articulated by 1932, and therefore anteceded the essentially *ad hoc* development of Roosevelt's policy. Jackson argued that Blum's analysis of the depression and policy prescription answered to a well developed Marxist interpretation. Quoting Jackson (1985) on the socialists economic programme which had been, "...almost fully worked out by the elections of 1932, but Roosevelt did not become President until January 1933." (p.38). By this we take him to mean an underconsumptionist model, viz., the contradiction between increased production and the inability to absorb the concomitant surplus, if this is indeed the case it sits ill with Blum's statement, quoted above, which directs policy towards further stimulating production.

increase in the floating debt as well as a dramatic fall in exports. The ensuing trade deficit would have meant increasing protection which would have caused a further breakdown in international intercourse.

Fernand-Laurent was highly critical of the government's partial default on the Auriol bonds, particularly as the government had been planning devaluation all along.[131]

Illustrating the strains on the Popular Front coalition, Duclos, a communist, argued that one should be frank and admit that this was a devaluation, as opposed to a re-alignment, and that measures needed to be taken in order to protect the working class from its effects.[132]

Pierre Mendès-France, a radical, struck a more supportive note in favour of the government. He argued that deflation had failed,- some in the Chamber were quick to point out that deflation had been practised by radical governments. French gold losses had already been very significant under Laval. Economic activity had begun to pick up in other countries as of 1935, but not in France because of the policy of deflation. The only solution was devaluation. Mendès-France argued that other countries had abandoned gold because France had been unable to offer appropriate commercial agreements,- undoubtedly a reference to Belgium. Mendès-France defended the government's policy of not devaluing immediately, on the grounds that it was unpopular and the government had tried reflation. Mendès-France made allusions (as Reynaud had done in his analysis of the causes of the depression) to the need to raise wholesale prices (*prix de gros*) as opposed to retail prices (*prix de détail*). Given the significant wage cost component of retail prices this suggests an explanation of the depression based on the notion that the real wage was too high.

Mendès-France pointed out that under various governments which had pursued deflation, borrowing from financial markets of some 60bn. had been made, and that direct and indirect advances from the Bank to the Treasury amounted to 23bn. francs, excluding the British loan of some 3bn. francs (4bn. at the new parity). As a result most of the revaluation profits to be realised on the Bank of France's gold stock had been wasted. Mendès-France also made a distinction between the existing situation and that when the British devalued. In the present circumstances world prices were rising, whilst when the

[131] op.cit., p.2783.

[132] op.cit., p.2789.

British had devalued the opposite had been the case. It would therefore be necessary to control domestic prices. He also suggested that it would have been better to have devalued before the social measures had been introduced. Mendès-France ends by stating that the radical party had reservations about indexation.[133]

Radical opposition to wage indexation caused the government to modify the bill, to replace indexation by measures which would allow the government to control price rises by decree.

R.Schuman, whilst accepting the devaluation, expressed his concern about its effects on prices and warned against wage indexation. Schuman cautioned that measures needed to be taken to balance the budget. Only then could interest rates be lowered and debt conversion take place. Schuman pointed out that the 1937 budget deficit was expected to be 10bn. francs, though he admitted that this was largely out of the government's control (undoubtedly alluding to the costs of re-armament). Nonetheless, the devaluation bill would increase government expenditure a further 1.7bn. francs. This must be attributed to measures incorporated to reverse several of the cuts in state pensions (particularly military ones) which had been made by decree in the period 1934-35.

Finally, Schuman rejected Auriol's suggestion that capital inflows would allow the government to fund its increased defence related expenditure. Schuman pointed out that for that to happen one needed a climate of confidence. He proposed an amendment which would have committed the government to ensure that when a definitive stabilisation occurred this would be on gold.[134] L.Marin proposed an amendment which would have guaranteed that within three months of stabilisation a government would strike gold coins,- both amendments were defeated.

Blum defended his policy on the grounds that the elections of May 6th had roundly rejected deflation.[135] Blum pointed out that in many quarters he had been urged to devalue as soon as he came to office. This would have allowed him to blame devaluation on his predecessors' policy failings. One cannot but think that this was indeed a missed

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[133] Quoting Mendès-France. "*Le groupe radical a fait notamment quelques réserves en ce qui concerne l'échelle mobile des salaires.*" From, Journal Officiel, Chambre des Députés, devaluation debate 28-30/9/36, p.2794.

[134] ibid.,p.2801.

[135] ibid., p.2810.

opportunity. Blum had rejected this, because he had thought that his policy could avoid this and that the government would be able to raise sufficient domestic capital to fund its programme. In his defence Blum argued that even if he were to admit to having made a mistake, surely it was best to take remedial action. Drawing a parallel with the US, he argued that the virtue of the Roosevelt administration lay in its trying one method after another to deal with the depression.[136] Blum admitted that he had not succeeded in raising sufficient domestic capital and that this had been partly due to the unfavourable and fast deteriorating international situation.

Blum argued that the decision to devalue had been taken in order to protect the Bank's gold reserve. He denied the contention that the government had devalued in order to secure the profits on the Bank's revalued gold reserve, a charge which would be levied against his government in the Senate. Blum pointed out that of the 10bn. franc credit which the Bank had extended to the Treasury, with parliamentary approval, only 1.5bn. had been used to date. The government therefore still had a credit line of 8.5bn. francs.

Blum defended his negotiations on stabilisation with the US and UK governments, which had begun on 6/6/36, on the grounds that the government had to prepare itself for all contingencies. However, this is, to say the least, disingenuous as it is pretty clear that the government did not consider this as some possible option, but was intent on devaluing,- albeit within the confines of an international agreement. One might add, in mitigation, however that stabilisation had been French policy since 1933 and that governments had been actively engaged in such negotiations since 1935. By which time stabilisation had clearly become a euphemism for an internationally sanctioned devaluation of the franc.

On the social aspects of the bill (articles 14, 15 and 15 *bis*) which mainly concerned wage indexation, Blum indicated his willingness to compromise given opposition from parties of the left, i.e., the radicals. In their place he proposed decree-making powers to regulate price increases in order to protect purchasing power. The terms of this proposed mandate, incorporated in the Campinchi amendment, were vague and by implication lent the government significant authority. The amendment was passed, but, as we will see, it would fail to pass the Senate hurdle.

Max Hymans speaking on behalf of the *union socialiste et républicaine* stated that his

[136] op.cit., p.2810.

group had supported devaluation for years. But measures should be taken to avoid price rises, such as lowering tariffs and phasing-in the 40hr. week and social legislation. In order to lower interest rates confidence needed to be restored. To do so the government would have to balance the budget, then it could go to the market and borrow.[137] Hymans stated that his group would vote the bill, but that devaluation only constituted a first step.

As we know, the Popular Front implemented measures directly contrary to the objective of restoring confidence and a return flow of capital, e.g., the confiscation of windfall capital gains realised on gold holdings. The bill included measures to tax 50% of the profits arising out of stock market operations conducted before the closure of the exchange on 26/9/36. And according to article 13 all spot and forward foreign exchange transactions conducted between 1st to 26th September had to be declared to the Ministry of Finance. Only in March 1937 was a belated effort made to restore confidence,- any effect was only short-lived.

A.Philip, speaking on behalf of the socialists, argued that devaluation had become inevitable after the policy pursued during the past five years. Devaluation in other countries had only made the situation worse for France. As devaluation had become expected it had become increasingly difficult to tap domestic capital markets. Philip rightly pointed out that Germain-Martin had, in 1934-35, tried to establish the sort of international co-operation which the Tripartite Agreement had brought. There is no doubt, however, that Germain-Martin had sought a more binding accord. In defence of the Popular Front government what can be said, and is apparent from our study of the British government's stance, is that the UK government was emphatic in its refusal to enter into any binding currency agreement.

Jammy Schmidt, the *rapporteur* of the Finance Committee, warned that the government could not accept a Senate rejection of the compensatory/social measures incorporated in the bill. However, this is exactly what would happen, and it is clear that the government had to make a significant climb down.

Auriol, in an attempt to speed up the proceedings, pointed out that the US and UK had already closed their financial markets on both Saturday and Monday as an act of solidarity.[138] The bill was passed by 351 votes to 217 against, out of 568 voting,- it then

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[137] op.cit., p.2829.

[138] op.cit. p.2860.

went on to the Senate.

The bill got a rough reception in the Senate where Caillaux, the chairman of the Senate Finance Committee, spearheaded an attack on the social or compensatory aspects of the devaluation bill.[139] Devaluation itself was accepted as inevitable, though the Times pointed out that that part of the bill was voted with such a slender majority as to constitute an indictment of government. The Senate rejected the wage indexation clause. After some debate the Chamber modified the bill giving the executive powers to combat price rises by decree. The Times suggested that, if anything, this appeared even more objectionable to the Senate. A political crisis appeared in the offing, but eventually the Popular Front had to climb-down and accept a formula which would allow the government to put labour disputes arising from increases in the cost of living to compulsory arbitration. The difficult position facing the Blum government in holding together a somewhat heterogeneous coalition is illustrated by some radical-socialist opposition in the Chamber to wage indexation. Caillaux himself was a radical. There was communist reticence on devaluation from the outset. There was also unhappiness amongst radical-socialist senators concerning the way the government was dealing with "stay-in" strikes.[140]

A critical examination of the Senate debate can be particularly useful in lending an insight into the political debate on the devaluation issue and its perceived redistributive impact,- of course deflation was not neutral in its redistributive effects. Many of the criticisms of the devaluation package voiced in the Senate would be vindicated by later events.

Abel Gardey, the *Rapporteur Général de la Commission des finances* in the Senate, led the onslaught in the first senatorial debate on 30/9/36.[141] He argued that devaluation was not likely to lead to a capital inflow because of the provision to further devalue the franc. The bill was not accompanied by measures to reduce expenditure, rather the contrary the government appeared set on spending more. Blum would repeal some of the cuts in pensions instituted by decree in the previous years. The bill did not include proposals to reduce the outstanding debt, such as the UK's 1932 debt conversion. And the bill suspended

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[139] see: The Times, 2/10/36.

[140] see: Herald Tribune, in, M.F., B 32 325, 1/10/36.

[141] see: *Annales du Sénat, débats parlementaires* (1937).

gold flows, subject to Bank of France licence. One might add that the measure to fully tax any gains made on forward exchange transactions and gold holdings, which were part of the devaluation package, certainly killed off any chance of significant capital inflows prompted by a desire to realise capital gains.

On the question of indexation, Abel Gardey was thoroughly dismissive, arguing that either one compensated everybody, in which case devaluation was pointless, or parliament gave the government authority to pick those groups which should be compensated. In the latter circumstance government would acquire too great an authority.[142] Later in the debate senator Fourcade, speaking on behalf of the *Union Républicaine*, argued that in its original draft the proposed compensation measures were in complete contradiction with the policy itself as they would merely raise costs to their former level and could only be the prelude to a further devaluation[143],- in the event he was right.

The attack was pursued by senator Farjon, also speaking on behalf of the *Union Républicaine*, explaining why his group would vote against the bill. Farjon pointed out that measures to implement the 40hr. week were still going ahead and that these would further raise costs, although he conceded that devaluation would allow these increases to be absorbed. However, wage indexation would feed into the price level and measures such as the reversal of cuts in pension would only fuel the budget deficit, as a result a price spiral could be expected.[144]

Comte Louis de Blois attacked Auriol for his deception over the devaluation issue and the issue of "Auriol bonds" to small-savers who had been deceived into purchasing these

[142] Quoting Senator Gardey in the first senatorial debate commenting on the social measures accompanying the devaluation bill, "*S'agit-il de sauvegarder le pouvoir d'achat de toutes les catégories sociales touchées par la dévaluation? Alors, la dévaluation est inutile, puisque les prix de détail rejoindront immédiatement leur parité or.*"

"*Au contraire, s'agit-il de choisir entre les victimes de la dévaluation? C'est alors donner au Gouvernement une délégation dont la gravité éclate.*" in, Annales du Sénat, débats parlementaires (1937).

[143] Quoting senator Fourcade, "*...Car tout se résumait alors à une contradiction absolue. Vous proposiez la dévaluation en l'assortissant de tout ce qui pouvait la rendre inopérante, inutile, et en faire le principle d'une nouvelle dévaluation.*" From, Annales du Sénat, ibid., p.1412.

[144] It is intersting to note that in the UK when devaluation was discussed within the policy-making establishment, in 1931, similar arguments were adduced against devaluation. cf., Eichengreen (1981).

bonds by Auriol's frequent denials that the government would devalue.[145] Senator Lesache pursued the accusation.[146] However, Auriol defended his action on the grounds that had he declared his intention he would have precipitated a devaluation. Senators opposed to the government would also argue that had devaluation been included in the Popular Front's electoral programme it would not have been elected.

Lesache condemned the government's presentation of the Tripartite Agreement as conforming with the objective of French policy pursued since 1933, viz., an international stabilisation accord. Lesache pointed out that the Tripartite Agreement was non-committal and the only guarantee that it incorporated was that the UK and US would not retaliate. No stable parity for the franc had been agreed and it could depreciate between 29% and 35% of its former parity or the equivalent of a 14% or so band of fluctuation. Lesache argued that the devaluation would particularly hit those on fixed incomes and the *rentes* in particular. However, as was pointed out during the devaluation debate by some proponents of devaluation, if it relieved the government's fiscal crisis and resulted in lower interest rates the *rentes* would actually rise (government bond prices would rise). Lesache argued that those in employment, on the other hand, would be partly compensated by rises in wages. Lesache accused the government of devaluing in order to realise the 16bn. franc windfall capital gain on the Bank of France's revalued gold reserve in order to relieve its Treasury position. Finally, Lesache criticised the government for failing to accompany devaluation with measures aimed at balancing the budget as Poincaré had done. Expenditure was even set to increase as the government was intent on repealing some of Laval's economy measures. Lesache bemoaned the passing of the middle class with this confiscatory devaluation.

Senator Lémery pursued the attack on the government's marketing of the devaluation

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[145] Quoting Louis *Comte de* Blois's attack on Auriol's frequent denials that the government would devalue, "*Ce que je reproche, non seulement à vous, monsieur le Ministre des finances, mais aux gouvernements qui se sont succédé, c'est d'avoir dit : "Nous ne ferons jamais la dévaluation", et de l'avoir en même temps préparée.*" in, Annales du Sénat, débats parlementaires (1937) p.1406.

[146] Senator Lesache quoted Auriol's July statement which accompanied the issue of Auriol "baby bonds", "*L'intérêt bien compris des possesseurs d'or ou de billets de banque vas les porter à placer leurs avoirs, surtout maintenant que le danger de la dévaluation est écartée et que la situation monétaire de la France devient tout à fait rassurante. La réserve des petits épargnants était parfaitement compréhensible jusqu'ici. Elle ne l'est plus depuis que l'Etat poursuit une saine politique économique.*" in, Annales du Sénat, débats parlementaires (1937) p.1407.

as an international alignment and stabilisation of currencies as "*camouflage*" and argued that it was purely and simply devaluation.[147] Lémery would also lambast Auriol for taking legal action against bankers accused of undermining the franc pointing to the hypocrisy of such action, when in mid-August Auriol had published an article in, Tribune des Nations, in which he had condemned devaluation the more so as it was often camouflaged under the repulsive guise of a re-alignment of currencies.[148] Auriol defended himself arguing that it was an extract from a speech which he had delivered in different circumstances.

Lémery attacked the socialists for not incorporating devaluation in their programme and quoted Blum's 16th June statement that nobody was considering devaluation outside of an international agreement. According to Lémery these conditions had not been met and the UK and US had only acquiesced in France's devaluation. Lémery rather tellingly enquired as to what the currency was being aligned on. According to Lémery the realignment was but a euphemism for devaluation.[149] Senator Bosc made a similar point arguing that the UK still retained its full currency autonomy, indeed this is explicitly stated in the British declaration. Bosc also argued that declarations not ratified by the US Senate did not count for much.[150] In reference to the British devaluation he pointed out that reductions in expenditure had been made, that the country was not prone to such social strife, and that the UK devaluation had been followed by a debt conversion operation.

The socialists were attacked for planning the devaluation since June while Blum had talked of the nation opening a credit on itself. The resources granted had amounted to some 13bn. +10bn. francs and he was now asking for more. This was somewhat unfair though as the 14bn. (not 13bn.) had been merely to regularise the situation which the Popular Front

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[147] see, Sénat, ibid., p.1409.

[148] Senator Leméry quoted the following extract of a speech by Auriol from an article published in, Tribune des Nations, "*...la dévaluation doit être écartée en raison même des précautions qu'elle prend aux yeux du public pour camoufler son caractère répulsif*"; *il claissait dans ces précautions l'euphémisme d'"alignement des monnaies", s'écriant: "Alignement sur quoi?.."*

"*Et M. Auriol me donne encore raison, car il n'envisageait d'autre base que l'alignement sur l'or. Il n'imaginait une révision de la valeur du franc qu'après définition de celles de la livre et du dollar. Monsieur le ministre des finances ou cette définition?*" in, Annales du Sénat (1937) p.1410.

[149] The following is an extract from senator Lémery's ironic attack on Auriol's use of the expression, "*opération d'alignement des monnaies et de stabilisation de changes,*" to define the Tripartite, "*Alignement des monnaies, a-t-on dit. Simple euphémisme, messieurs, pour faire sournoisement la dévaluation, car enfin, messieurs, l'alignement? Sur quoi?*" in, Annales du Sénat, ibid., p.1409.

[150] in, Annales du Sénat, ibid., p.1421.

had inherited from previous governments. Auriol would strenuously deny this charge, arguing that of the profits realised 10bn. were going towards a stabilisation fund and the rest to pay-off part of the Treasury's borrowing from the Bank. However, given the precarious nature of the government's finances clearing part of the "overdraft" would only open the way for further borrowing.

Lémery would add that countries such as Belgium might retaliate against French devaluation and that the UK and US could always let their currencies slip. As far as measures to compensate for devaluation were concerned these could only lead to a wage/price spiral. According to Lémery the franc was being devalued not because it was overvalued, but because of the budget deficit (which was part monetised). This is part true, but our argument has been that the overvalued exchange rate and a perverse macro-economic stance worsened the fiscal crisis. This was somewhat mitigated by the increasingly loose monetary policy which resulted from the political inability to resolve the fiscal crisis. This opened the door to the progressive monetisation of the deficit.

Auriol speaking in defence of the devaluation, before the Senate, argued that deflation had failed, and that reducing incomes and prices within the context of economic depression had only resulted in compounding difficulties.[151] Auriol pointed out that there had been exchange crises since 1935 which were accompanied by substantial gold losses and that previous governments had resorted to indirect advances from the Bank. Auriol indicated that in the six weeks from 26th April to 7th June 1935 the gold reserves had dropped from 81bn. francs to 71bn. francs;[152] that in a week at the end of May 1935 the Bank had lost 5bn. francs worth of gold. And in the six weeks from 25th October to 6th December 1935 the Bank's gold reserve had dropped from 72bn. francs to 66bn. francs. Auriol, pointed out that when he first appeared in his capacity as Finance Minister before the Finance Committee, on 18th June 1936, the gold reserve only stood at 54bn. francs. On this basis he defended his policy as a means of saving France's war chest. The international situation had worsened with the Spanish Civil War and the extension of military service to two years in Germany, in the circumstances two solutions presented themselves to the government: devaluation or

[151] Quoting Auriol in the Senate, "*L'exemple de tous les pays nous prouve que le destin d'une politique de compression des revenus et des prix sous l'effet de la crise est de se dévorer elle-même.*" source: Annales du Sénat, ibid., p.1414, 30/9/36).

[152] That was the week the Laval government fell.

exchange controls.

Auriol quoted Caillaux, who on 11th June, had admitted that deflation had failed and that devaluation was needed as well as measures to increase trade. However, Caillaux had wanted devaluation as part of a stabilisation agreement on gold. Caillaux condemned the Tripartite Agreement as inadequate, he would have wished a binding accord. However, as we have seen in chapter eight this was unrealistic as the British government would never have agreed to a binding commitment. Caillaux argued that Auriol should have adopted the proposal he had made on 12/8/36 to stem the gold outflow. This would have ensured that gold was only delivered to settle balances arising out of commercial transactions, as apparently was the practice in Amsterdam. Caillaux had argued that otherwise the Bank of France, where gold could be obtained freely, would continue to be pillaged by speculators and the British Exchange Equalisation Account. Failure to implement this measure meant that France had become the last significant free gold centre.[153] However, Auriol pointed out that such measures would be tantamount to exchange controls and therefore devaluation.[154] On the question of social measures and wage indexation Caillaux argued that they would lead to another devaluation.

Senator Linyer, speaking on behalf of the *gauche républicaine*, condemned devaluation, arguing that his group would vote against it because deflation had not been given enough time! More cogently he argued that for devaluation to be a success it would have to be supported by order in the country, an attempt at balancing the budget, and that without these measures another devaluation could only follow.

Blum speaking in support of his request for accompanying social measures argued that when the UK had devalued world prices had been falling and that the opposite was now the case in France. Blum argued that it was better to offer some indexation than face social strife and that if 33-10% were offered this was but little in practice, as wage costs only accounted for some 30% of total input costs. However, this abstracts from the dynamic nature of wage/price spirals particularly in as confrontational a social environment as then prevailed. One should add that the proportions that he mentions would be sufficient to cause

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[153] The Fed. would only deliver gold to authorities offering reciprocal facilities; hence, the importance of the French franc for the conduct of sterling foreign exchange intervention, cf., section on the 24hr. exchange guarantee agreement in chapter eight of this thesis.

[154] see: Annales du Sénat, ibid., p.1418.

a significant percentage drop in profitability. Blum was adamant that some compensation should be offered and that the government would not accept a Senate rejection of such measures. This opened the way for a political crisis. However, in the end the bill was passed in a heavily adulterated form. The only concession being an agreement to allow arbitration in certain cases where price rises might be considered unjustified. The bill certainly got a rough ride through the Senate and Blum admitted as much before the floor.

When the bill returned to the Chamber of Deputies on 1/10/36 the right, rather opportunistically, welcomed the removal of pension cuts made during the period 1934-36. These had amounted to 3% and then 10%. They had been decreed on 14/4/34 (under Doumergue) and 16/7/35 (under Laval). However, the right bemoaned the fact that devaluation would reduce the gold value of pensions by 30%.

Jammy Schmidt, rapporteur of the Chamber's Finance Committee, announced that the Senate in accord with the government had replaced articles III; IV; and V by article 13 (*quater*) which aimed at controlling unjustified price increases following devaluation in the period up to 31/12/36. However, as we have seen in the original discussion in the Chamber and Blum's subsequent defence of his request for decree-making powers to regulate price increases before the Senate, this final package can only have been conceded reluctantly by the government and represented a significant climb-down. The proposed arbitration procedure would be established after opinion of the *Conseil National Economique* and would last for six months. It would statute on the extent to which price increases were unjustified and might have affected collective wage agreements. Certain mechanisms would also apply to agricultural commodity prices. Article 13 (*ter*) of the bill introduced a tax on profits realised on stock market operations, both spot and forward, over the period 21/9/36-26/9/36. This followed some discussion as to the period over which this should apply and the rate at which the tax should be levied.

L.Galimand, a radical-socialist, speaking in his own capacity stated that he accepted the devaluation, but insisted that the Prime Minister give guarantees concerning the maintenance of order in the country. He makes a clear distinction between "*ordre public*" and "*ordre légal*" and asks that the government give guarantees that the latter would also be respected. Speaking out against the occupation of factories he asked the prime minister to confirm that his interpretation of the "*ordre légal*" encompassed the occupation of factories.[155] Galimand's definition of the "*ordre légal*" consisted in the respect of property and individual liberty. This clarification certainly highlights the philosophical gulf between coalition partners within the Popular Front, viz., between the radical-socialists and the Marxist SFIO and communist party. Galimand also requested assurances that the *Rassemblement Populaire* was not a prelude to the sovietisation of France.

F.Wiedemann-Covian stated that the measures proposed were tantamount to the dispossession of the middle classes. He pointed out the irony of the government's devaluation, which reduced the purchasing power of all the French, whilst the Popular Front's economic programme had been based on increasing purchasing power. He accused the government of devaluing in order to disguise its bankruptcy and to secure the profits realised on the Bank of France's gold reserves.

Duclos, speaking on behalf of the communists, hoped that the compensatory social measures, for which the communists had fought hard, would be used to favour employees. Duclos pointed out that the communists had made a significant effort to keep the majority coalition together, despite attacks directed at the CGT and communists. The latter is a clear reference to Galimand, in this regard it is obvious that the Popular Front coalition was not bereft of tensions. Duclos finally stated that measures were needed to make the rich pay.

In a final indictment of devaluation, Georges Cousin of the *Fédération Républicaine* argued that he could not support the bill which consecrated devaluation, despite Senate modifications. He bemoaned the fact that the *rentiers* and representatives of the middle classes had not managed to lobby for their interests, though one cannot escape the impression that the Senate was quite successful in this regard. Cousin argued that it was not just devaluation which would impact on prices, but also the 40hr. week whilst strikes continued. However, the bill was passed. Amongst other measures attached to the bill was a 3bn. francs credit to the *Crédit Foncier* to reduce the interest it charged on loans outstanding to *communes*, and *départements*. Article six stipulated that outstanding international loans denominated in francs would be repayable at rates prevailing at the time they were contracted.

From the foregoing one cannot escape the impression that the Popular Front had to make significant concessions to carry its bill through the Senate or face a political crisis. In

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[155] see: Journal Officiel, Chambre des Députés, débats, p.2881.

the end the bill was passed through the Senate by 141 to 125 with 266 senators voting.

The devaluation bill was passed on the 1st October 1936 and the stock market reopened on 2nd October. The discount rate was reduced from 5% to 3%. And on the 3rd October 105 out of 750 import quotas were abolished, duties on finished goods were reduced 15%; on semi-manufactured goods 17% and raw materials 20%.[156] These measures were aimed at moderating any imported inflation, and as we saw in chapter eight constituted a tacit *quid pro quo* for US acceptance of the Tripartite Agreement.

THE TRIPARTITE AGREEMENT AND CURRENCY EXPERIENCE (1936-39):

Devaluation only offered a brief respite. In January 1937 Auriol was making statements rejecting further devaluation. However, on the 28th January the discount rate was raised from 2% to 4%. On the 29th January the French state railways contracted a £40 millions sterling loan from a British banking consortium, a way of both relieving Treasury borrowing and supporting the French franc.[157] Drummond's research (1979) reveals that the French authorities had originally sought a loan of £90 millions sterling. Neither Chamberlain nor Montagu Norman was keen on the idea. The loan was eventually scaled back to £40 millions sterling and was provided by Lazard's, as in 1936. According to Drummond Neville Chamberlain approved the loan to keep the Tripartite Agreement in existence, somewhat invalidating his thesis that the Tripartite Agreement did not amount to much, though it was not entirely altruistic as it might serve to stave off a French devaluation which would would undermine British competitiveness.

Drummond stated that the weak franc in winter 1936-37 and capital outflows had prompted Montagu Norman to suggest to de Labeyrie that he should allow the franc to float more freely, that the budget be brought under control, and Auriol sacked![158] Montagu Norman's suggestion that the franc be allowed to float more freely marked a change of policy. When the French authorities had been discussing devaluation in September 1936, the

[156] see: Survey of International Affairs (1937) p.6.

[157] see: Survey of International Affairs, p.194.

[158] According to Drummond (1979), London thought Blum financially ignorant and Auriol incompetent, *op.cit.*, p.54.

British would have preferred the franc to be pegged at a fixed parity to gold. This would have allowed them to manage the sterling/franc exchange rate independently. In February the French authorities were still pressing for a commitment to fixed exchange rates to bolster the franc. This was rejected by the British who stressed the need to address the budgetary imbalance. The British authorities were also unwilling to consider intervention measures which might involve pooling of reserves. Morgenthau was of the view that the French should devalue by 8%, but Neville Chamberlain refused to approach the French government on the matter. Nevertheless, Neville Chamberlain expected that the £40 millions sterling loan would soon be exhausted.

The Blum experiment was running into the sands. Lefranc (1974), a socialist and chronicler of the history of the left in France, concluded that the economic policies of the Popular Front were a failure and perhaps even hampered economic recovery.[159]

Eichengreen illustrates the large budget deficit which the government ran after devaluation. He gives the following figures for the French budget deficit,[160] in 1936 it amounted to 30% of expenditure and 7% of GNP; and 32% and 7% respectively in 1937. The large deficits and the removal of the "golden fetters" meant that there appeared to be no more discipline to restrain the profligacy of the Popular Front government which led to further uncertainty, capital flight, and French franc weakness.[161] However, Eichengreen argues that these factors cannot account for the failure of economic recovery in France, as Roosevelt had confronted similar difficulties. However, this is a false analogy as the Popular Front government was a coalition which had been gravely weakened by devaluation and Blum was more frightening than Roosevelt, particularly as he relied on tacit communist support.

Eichengreen attributes the poor recovery in France to "a negative supply shock on a massive scale," viz., the decline in working hours; strikes; as hours worked were reduced workers asked for compensatory increases in hourly rates; and wage increases outstripped

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[159] Quoting Lefranc (1974), "*Economiquement, on doit conclure à un échec du Front Populaire. Il n'a pas réussi le redressment qu'il espérait réaliser; il l'a sans doute compromis.*" p.340. One should note that Lefranc was a socialist. A view implicit in Kemp's (1972) analysis, "What blocked French recovery in the mid-1930s was the continued crisis of confidence in the bourgeoisie, exacerbated by the "great fear" of 1936 when the country seemed to stand on the brink of revolution." p.146.

[160] see Golden Fetters, p.384.

[161] see Eichengreen Golden Fetters, pp.383-384.

those in prices and real wages rose, rather than fall as in other countries.[162] Quoting Eichengreen, "Blum's devaluation of the franc consequently failed to reverse two principal distortions imparted by years of delation: rising real costs of production and falling profitability."[163] Mouré (1991) cites a figure of 60% for increase in hourly wages for the first nine months of Popular Front government.[164] As profits, exports, and investment did not turnaround the government retrenched on the fiscal front.

However, if one looks at the figures for comparative economic performance in Appendix (table A-1) one can see that economic activity did pick-up considerably, the reason that Blum had to retrench was to stem the financial and treasury crisis that followed the first devaluation. One should add that the government had also the additional burden of steeply increasing defence spending commitments.[165] Mouré quotes J.-C.Asselain (1980) who argued that though the 40hr. week acted as a constraint on recovery in 1937 it was only one among many.[166] Mouré attributes the increase in activity not so much to the devaluation,[167] as it came so shortly on the back of it, but, "that a combination of the Popular Front's reflationary effort and the fears of further devaluation encouraged imports and increased domestic activity."

On 14th February 1937 Blum suggested that it was time for a pause.[168] This brought some relief. This policy switch was confirmed following a cabinet meeting on 5th March. Blum was gradually to reverse all the measures which had been taken against speculative profits realised as a result of devaluation, in order to encourage a capital inflow. It was announced that the Bank of France would buy and sell gold at the equivalent of 45 milligrams per franc as of 8/3/37 and no questions would be asked concerning the identity of those conducting these transactions. Restrictions on the export and import of golds were

162 Golden Fetters, p.384.

163 Golden Fetters, p.385.

164 see also Eichengreen Golden Fetters, pp.384-385 for figures.

165 see chapter four of this thesis.

166 Mouré (1991) p.272.

167 Mouré (1991) p.272.

168 see: Survey of International Affairs.

lifted. The Tripartite was re-affirmed and a committee of experts was appointed to manage the Exchange stabilisation fund. Its members were Charles Rist; Paul Baudouin, a banker; Jacques Rueff; and de Labeyrie, the Governor of the Bank of France. They were entrusted with managing the fund on 25/3/37. They allowed the franc to gradually float down towards the minimum parity of the Franc Auriol, or "*franc élastique*" (because of its permissible bands of fluctuation).[169]

A national defence loan incorporating an exchange guarantee was issued (as Caillaux had done in 1925). The bill approving the loan was passed on 10th March and incorporated compensation for those who had surrendered their capital gains on their revalued gold holdings to the Treasury.[170] The government also adopted policies aimed at controlling government borrowing.[171] These included a prohibition against spending beyond credits agreed in the budget, except to compensate lower grade civil servants, and Treasury demands on the capital markets would be restricted to 8bn. francs.[172] In April 1937 the franc was allowed to drop from 105 to 112 to sterling, an 8% fall.[173]

The franc drifted down and the exchange equalisation account lost gold. On the 14th June both Rist and Baudouin resigned from the management of the exchange equalisation account when their plan for austerity measures was rejected. Rueff, director of the Treasury, though evincing sympathy for their point of view, did not resign. Mouré opines that had the government not fallen Auriol would have had to replace Rueff.[174] On the 15th June the Blum government requested decree-making powers. These were voted by the Chamber, but twice refused by the Senate and the Blum government fell. Drummond suggested that Blum was favourable to exchange controls, but rejected them to avoid a break with the "anglo-saxon" democracies and undermining the Tripartite Agreement.

The Blum government was succeeded by a government headed by a radical,

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[169] see Pirou (1938).

[170] see: Survey of International Affairs, ibid., p.196.

[171] see Pirou (1938).

[172] see: Survey of international Affairs, ibid., p.196.

[173] see Drummond (1979).

[174] Mouré (1991) p.270.

C.Chautemps. The new Finance Minister, G.Bonnet, did not think much of de Labeyrie and had him removed. Bonnet was of the view that too much gold was being lost and that the franc would not hold.[175] Markets were closed on the 29th and 30th June 1937 and the government was given authority to deal with the crisis of the franc by decree.[176] A decree law on 30th June established a freely floating franc (the "Bonnet franc" or "*franc flottant*"). The exchange equalisation account was entrusted with smoothing its fluctuations. Drummond remarked that, "The situation was ironical. In June 1933, Bonnet had been the apostle of absolute fixity in exchange rates; in June 1937, he wanted the franc to float as freely as possible."[177]

According to Drummond (1979) the Chancellor of the Exchequer, Sir John Simon (who had replaced Neville Chamberlain after his move to number ten) wondered whether this was consistent with the Tripartite. Waley of the Treasury did not want to see the franc drop below 124 per pound sterling. Bonnet refused to make an exchange rate commitment. In mid-July 1937 Bonnet simply stated that the currency would be managed by the Exchange Stabilisation Fund. However, Bonnet presided over a period of credit creation and the franc continued to weaken.

On the 21st July 1937 the gold stock of the Bank of France was revalued for the third time since 1928 and the profits were credited to a fund to stabilise the value of government gilt-edged stock (*Fonds de soutien des rentes*). Measures were also adopted to fix prices.[178]

On 20th July Labeyrie had been replaced as Governor of the Bank of France by P.-E.Fournier (Governor: 21/7/36- 31/8/40). Labeyrie's opinion was that he was dismissed as Governor (Governor: 6/6/36-20/7/37) because he supported exchange controls.[179] This is consistent with Drummond (1979) who stated that Bonnet wanted to avoid exchange controls. Sir Frederick Phillips told Morgenthau that if France introduced exchange controls, the British government would consider that France had left the Tripartite Agreement.

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[175] see Drummond (1979).

[176] see Pirou (1938).

[177] Drummond (1979) p.17.

[178] Sauvy (1984) vol.I, p.401.

[179] see: B.F. *Archives, dossiers gouverneurs*.

It appears that Morgenthau was not unfavourable to exchange controls. In October 1938, Morgenthau asked Monnet to approach the Daladier government with a proposal both to assist in the repatriation of French capital held in the US, as well as exchange controls. However, Daladier's government was in crisis over the issue of exchange controls. By the time Monnet had crossed the Atlantic Daladier had reshuffled his government and Reynaud was now at the Finance Ministry (replacing Marchandeau). Reynaud rejected coercive policies.[180] Drummond, who forms a very poor opinion of Morgenthau, pointed out that Morgenthau's stand on the exchange control issue varied with the strength of the franc. Drummond also made the point that Morgenthau's advocacy of exchange controls was at odds with the more liberal economic regime to which the Secretary of State, Cordell Hull was committed. The British did not want Paris to introduce exchange controls. They recommended, "budgetary responsibility and social prudence."[181] According to Drummond (1979) the British were of the view that the French authorities would not be able to maintain exchange controls.

By September 1937 the French authorities were having difficulties supporting the franc at 145 to the pound. The £40 millions sterling Lazard loan was due in December and the Exchange Stabilisation Fund had funds only equivalent to £42 millions sterling. The City suggested that the gold of the Bank of France be used for this purpose. This would have involved altering the law or returning to gold. Monick told Phillips that Paris would like to consolidate £20 millions sterling of the loan into a three year loan, and repay only half the sum due. However, Sir John Simon informed Bonnet that the credit could not be renewed. The UK authorities were of the view that Paris should do something to address the budgetary situation.[182]

Chautemps faced a wave of strikes and capital flight. After an attack which he launched in parliament against the communists, the socialists withdrew from his government,- in which Blum had served as deputy-prime minister.

Chautemps formed a new government in January 1938, and Marchandeau replaced Bonnet at the Finance Ministry. The Exchange Fund was exhausted. Marchandeau thought

[180] see Drummond (1979).

[181] Drummond (1979) p.52.

[182] see Drummond (1979).

that he might have to introduce exchange controls. Drummond also suggested that Marchandeau was considering returning to gold, but without a fixed parity. Returning to gold would have allowed him to use the Bank of France's gold reserves for exchange support operations. But, this sounds rather a nonsense, "how could one return to gold without fixing a parity?" The Bank of England wanted France to devalue, which would yield net profits of £160 millions sterling which could be used for intervention purposes.

Drummond also records that in February 1938, Monick approached both the US and UK governments over the possibility of a more extensive agreement than the Tripartite. However, both governments indicated that the initiative must rest with the French. In March 1938 when Blum formed his second government the franc continued to weaken. This appears to have put paid to talk of stabilisation. The British authorities feared that the centralisation of foreign exchange transactions, which Blum proposed, was a prelude to exchange controls.

Blum's short-lived government fell before the Senate in early April 1938 when he requested decree-making powers which included exchange controls. Blum had realised, belatedly, that it was not possible to conduct the sort of policy which he wished without a protective armoury of exchange controls.

The franc continued to weaken in April, under the new Daladier government. Montagu Norman attributed this to Reynaud's opinion that the franc, which was supported at 160 should be trading at 175 francs to sterling. Drummond recorded that the British authorities were not happy with the fall in the franc. They argued that it could be held at 160, nor were they enthusiastic about the tariff increases and quota reduction, despite Blum's promises in September 1936.[183] The US was worried that France was competitively devaluing and not consulting in the spirit of the Tripartite Agreement. A sentiment shared by the British authorities. Nevertheless, there was no condemnation of France's policy so as not to undermine the little co-operation that existed.

Drummond points to the steady drop in the franc's value to dispel the belief that the Tripartite incorporated any commitment to fixed exchange rates and the lack of consultation as further proof of the limited nature of the Tripartite Agreement. Drummond also pointed out that though in 1936 the US authorities had wanted a dollar/sterling parity of $5.00, by

[183] cf., Drummond (1979).

1938 they acquiesced in a dollar/sterling rate of $4.68.

On the nature of the Tripartite Agreement, Drummond concludes that, "The declarations were vague, concealing profound disagreements and committing the three governments to little or nothing," however, "Given all the circumstances, the Tripartite Agreement may well have been the best that could reasonably have been expected."[184] And that, "Without the Tripartite Agreement, however, the French might have felt free to let the franc drop farther, faster, or more irregularly. The Agreement at least gave Britain and the United States a license to remonstrate."[185] It is difficult not to agree with Drummond's judgment.

Kindleberger interpreted the Tripartite as a major step forward in international monetary relations, preceded by Cordell Hull's 1934 Reciprocal Trade Agreements Act, and the relaxation, in 1938, of the Empire Preference scheme with an Anglo-American trade agreement. Drummond has been critical of this sort of assessment of the Tripartite as marking a substantial shift in international economic relations, particularly in the monetary field. Our view is that although there was a movement in the trade field, Drummond's (1987) emphasis on the limited nature of the Tripartite Agreement is substantially correct.

On April 29th 1938, Bonnet, now Minister for Foreign Affairs, told the Chancellor of the Exchequer, Sir John Simon, that he did not think that they could hold the franc at 160. Bonnet asked whether the British Exchange Equalisation Account might support the franc. This was rejected by Simon, on the grounds that it would be illegal.[186] Simon was not helpful either when Bonnet asked about the possibility of a £30-40 millions sterling loan. Simon stated that the UK banks would not be keen, and would need a gold guarantee, "which could not be offered."[187] According to Drummond, Bonnet informed Simon on May 2nd that it was a choice between exchange controls or a franc sterling rate of 175. Bonnet promised that this would be the last devaluation, and that Paris would allow the franc to appreciate from then-on. The US and British governments had little choice, and the weakness of the franc made the rate of 160 untenable.

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[184] Drummond (1979) p.55.

[185] Drummond (1979) p.7.

[186] see Drummond (1979).

[187] Drummond (1979) p.34.

However, on May 5th 1938 the Daladier government pegged the franc against sterling at 179 francs. Both Morgenthau and Montagu Norman were angry. Montagu Norman told Cochran that the French had lied.[188] The French pressed for a statement to be released which would help stabilise the exchanges, but the British were not favourable. From then-on the French Exchange Equalisation Account gained gold., It held 2.1bn. francs worth of gold on 31/10/38, these rose to 14.3bn. francs in January 1939. Drummond attributed this inflow to the devaluation of 5/5/38. This opinion was shared by Pirou,[189] who thought it undervalued the franc on a purchasing power basis. The franc was allowed to appreciate slightly and in August 1939 it was pegged at 175 francs to the pound.[190]

This was the final ignominy. The franc was not only pegged to sterling, but sterling was off gold and floating! Drummond points out that from September 1936 to September 1939 it was the franc/sterling rate which the French authorities watched and that therefore, "France may be said to have joined the sterling area in 1936."[191]

CONCLUSION:

The ambitions which Moreau had entertained for the franc in the mid-1920s had failed. But, more significantly, the French economy had been subjected unnecessarily to deflationary policies for much of the 1930s, both imported and domestically induced. This had been instrumental in fomenting social strife, and disaffection with the parliamentary system on the right. This was evidenced by the rise of the Leagues. This disaffection probably made the Vichy government far more acceptable than might otherwise have been the case.

The monetary and political turbulence in France gained momentum just as Hitler remilitarised the Rhineland in March 1936.[192] France failed to react. Shortly thereafter France was prone to a series of strikes culminating in the "Matignon agreements" which resulted in large wage concessions. The Popular Front government also introduced the 40hr.

[188] Drummond (1979) p.36.

[189] see Pirou (1938) p.56.

[190] see Gignoux (1943).

[191] Drummond (1979) p.40.

[192] We now know that German troops had orders to retreat should they encounter any French opposition.

week and paid holidays (*congé payé*). The 40hr. week has been condemned by most economists, even of "leftish" persuasion, e.g., Marjolin (1938), for setting up supply-side rigidities, nor did it have the desired effect of reducing unemployment through work-sharing. The *congé payé* were actually a far cheaper way of making concessions to workers than pay rises,[193] and probably of far greater long term social impact. Reducing the working week whilst Germany was re-arming hardly sent the appropriate signal.

Though the Popular Front did continue the re-armament programme, which was to a considerable extent responsible for its financial difficulties and those of succeeding governments, one cannot escape the impression that most of the French political establishment was seemingly blind to the urgency of the impending threat.

The break came, in what had become a rake's progress in the state's public finances, with the partnership of Daladier as Prime Minister and Reynaud at the finance ministry. This afforded the typical mid-term realignment of political forces in a Chamber which enjoyed a nominal majority of the left. This had occurred in 1926 with Poincaré, and in 1934 with Doumergue and again in November 1938 when Daladier replaced Marchandeau,- who had favoured exchange controls[194],- with Reynaud of the *Alliance Républicaine Démocratique*. Following the defeat of the general strike of 24th to 30th November 1938 and the relaxation of the 40hr. week, particularly in the defence related industries, confidence returned and funds flowed back and France's exchange position improved. But there was no time to implement Reynaud's three year plan which included tax increases and curtailment of civil expenditure. On 3rd September war was declared on Germany and on 10th September 1939 Reynaud introduced exchange controls.[195]

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[193] Reducing the work week from 48 to 40 hours immediately raised unit labour costs by 20%, without taking into account the labour rigidities that this imposed and the extra costs of hiring labour for any additional hours worked. If over-time labour is paid at 1.5 the normal hourly rates this immediately raises the marginal costs per unit of output a further 50%.

[194] see Sauvy (1984) p.348.

[195] see Sédillot (1953).

CHAPTER 10

DID FRANCE DESTABILISE THE INTERNATIONAL MONETARY SYSTEM? THE MALDISTRIBUTION OF GOLD AND THE OPEN-MARKET POLICY CONTROVERSY

"The event which gave the signal for general deflation in 1929 was the change of policy on the part of the Bank of France, which ceased to buy foreign exchange, disposed of 6 milliards of the foreign assets it already held, and began to absorb gold at the rate of 10 milliards in a year. It was the reversal of the previous adherence to the gold exchange standard in one important case that disturbed a pre-existing equilibrium."[1]

In this chapter we aim to address one of the foremost policy issues which was particularly to divide anglo-saxon economic commentators and French economists and policy makers, namely the problem of the so-called maldistribution of gold and the related issue of open-market policies. In a sense the question of maldistribution could be considered the international aspect of the problem, whilst the debate over whether France should have engaged in open-market operations is more closely related to the question of domestic monetary policy and offsetting the sterilisation of gold which occurred as a result. Though both are intrinsically linked as open-market policies could have served to staunch the gold inflow.

The question of France's gold holdings became an international issue from 1928-32, the so-called "gold avalanche" period, when gold poured into France. This precipitated a lively debate as to why this occurred. "Was it deliberate in order to unseat sterling?" If not, "what was the cause and what could be done about it?" The issue was a particular cause for concern for British policy-makers as British gold reserves were relatively exiguous, particularly in view of potential capital outflows, outstanding liabilities, and relatively illiquid assets, e.g., central European loans. The sterilisation of gold and international liquidity was thought to have been instrumental in the drastic fall in world commodity prices and a leading

[1] Hawtrey (1933) p.218.

cause of the depression. This view was particularly shared by Sir H.Strakosch,[2] a leading economist of his day and member of the League of Nations Financial Committee from 1920-37 and chairman of the Economist;[3] as well as by Sir R.Hawtrey, Director (and sole member) of the Treasury Financial Enquiries section from 1919-45;[4] amongst other luminaries was the leading monetary economist of his day, G.Cassel. Their view is well expressed in the "Note of Dissent" appended to the League of Nations Gold Delegation Report.

The French view was that from 1929-on the Bank of France had not deliberately acquired gold but had merely accepted gold delivered to it against which it issued francs, as the 1928 Stabilisation Law dictated.[5] This gold movement occurred as a result of: surpluses on current account enjoyed by France; an insufficient interest differential in London's favour which meant that French financial institutions would repatriate foreign exchange holdings in the form of gold whenever needed; capital repatriation following stabilisation to realise foreign exchange profits and to satisfy the increased demand for cash balances following stabilisation. Mouré argues that London acted as Paris' short-term money market, as Paris did not offer adequate facilities.[6] As to the charge of sterilising gold inflows, the Bank of France argued, in its defence, that it stood ready to discount sound commercial paper, but

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[2] The biographical details of British and Empire economists are taken from Howson & Winch (1977). Further particulars made be found on, pp.371-381.

[3] see Mouré (1991).

[4] Hawtrey (1933) attributed the massive gold inflow to France in the period 1929-1931 to the Bank of France's need to cover its note issue. Previously, during the period 1926-28, the Bank had exceptionally been allowed to hold foreign exchange, i.e., it was on a gold exchange standard at the margin. This was rescinded with the stabilisation law of 1928, and France began to accumulate gold. Hawtrey argued that France's real money supply was low and that the Bank would have been justified in expanding the note issue.

However, the new legislation governing the note issue of the Bank specifically precluded the use of French government securities as cover for its liabilities, viz., the currency note issue and deposits held at sight. These had to be backed by real bills (which were in short supply) or gold. The legislation prescribed a minimum gold cover of 35%. This meant that economic agents could only satisfy their increased demand for real balances by bringing gold to the Bank. Financial institutions did so, in part, by drawing gold from London or remitting sterling denominated assets which if sold in the market would raise the franc to its gold import point. Hawtrey was particularly critical of the Bank's new legislation and was of the view that, "Here is the cause, at any rate the principal cause, of the loss of gold suffered by the Bank of England in 1929." *op.cit.*, p.131. Hawtrey was of the opinion that this had forced Bank rate up in the UK.

[5] see Aftalion's paper, "*Les causes et les effets des mouvements d'or vers la France*," submitted to the League of Nations Gold Delegation, in, M.F. file B 32 316.

[6] Mouré (1991) p.57.

that bills were not presented for discount in significant quantities. Therefore, there was not a deliberate policy of sterilisation, but, rather, the demand for credit was not sufficient, due to adverse business conditions, to benefit from the potential credit which the Bank could create against its assets, viz., gold.[7] These adverse conditions had been caused by the fall in world commodity prices which had been precipitated by over-production and lax credit policies,[8] particularly in the US. The Bank of France and economic commentators such as Aftalion pointed out that large deposits at the Bank of France belied the contention that the cause of the depression was due to a lack of credit, rather than "real" conditions of which the lack of credit demand was an expression.

The British view was that if this were the case the Bank of France should act on the supply of credit and money by engaging in open-market operations. The standard French response was that the Bank was precluded from doing so; that open-market operations in the US between 1930-32 had proved ineffective; and that the French money and credit market structure was such as to make open-market policies largely ineffective and redundant.[9] The Bank of France with its large branch network and direct discounting of bills did not need to engage in open-market operations in order to make its credit and monetary policy effective in the market, as was the case in the UK and US. It was only in 1938 that the Bank of France was finally permitted to engage in open-market operations.

One should note that the statutes governing the note issue had been specifically altered so as to preclude governments from financing themselves by means of direct discounts of Treasury bills and government bonds at the Bank, viz., printing money. Hawtrey never seems to have grasped this political dimension to the problem which was firmly rooted in the unfortunate experience of financial instability in France during the period 1919 to 1926. Open-market policies could have precipitated a run on the currency by undermining the credibility of the Bank's independence in monetary affairs, and reviving the memory of currency instability in the 1920s.

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[7] This is a standard banking school argument.

[8] Quoting Sandoz (1936), "*L'open-market policy, systématiquement généralisée comme elle l'a été aux Etats-Unis et particulièrement en Angleterre, a certainement contribué à retarder et amplifier la crise de 1929, en créant une aisance monétaire factice et en faussant l'action régulatrice des exportations d'or.*" The argument maybe consistent whilst applied to the UK, but not to the US which accumulated gold and had enormous reserves.

[9] see paper on open-market policies in documentary Appendix.

In this chapter we aim to track the debate over the issue of the so-called maldistribution of gold and open-market policies. The aim of this introduction has been to illustrate the intrinsic link between the question of gold "maldistribution" and open-market policies. In a recent monograph Eichengreen has argued that only open-market operations could have offset the effective sterilisation of liquidity which occurred as a result of the particularities of the French money-market,[10] hence its importance. The debate also underlines the degree of suspicion and misunderstanding which existed between Britain and France in the inter-war years. This was largely to be repeated in the sixties when France (with J.Rueff again playing a significant advisory role) accused the US of foisting a dollar exchange standard on the rest of the world, whilst it enjoyed the *seigniorage* of issuing the world reserve currency. The benefit in this case being the ability to run an unchecked balance of payments deficit - the need to maintain a fixed exchange rate and the desire for international liquidity ensuring an automatic financing, i.e., acquisition of dollar exchange by other central banks, with of course the ultimate cost of potential collapse as confidence in the vehicle currency is thereby undermined.[11]

The difference between the inter-war gold standard and the Bretton Woods gold exchange standard was that the former was deflationary with surplus countries sterilising gold inflows, whilst the latter was inflationary with the US eventually supplying a surfeit of liquidity. The breakdown of the Bretton Woods system would tend to confirm the prejudices of French inter-war economists against the inherently inflationary nature of a gold exchange standard. However, of more significance is perhaps the fact that both fixed exchange rates systems, viz., that prevailing during the inter-war years and Bretton Woods, when abused and worked unco-operatively broke-down. One might add that the latter proved more resilient as the costs of inflation are not as great as those associated with deflation, and that if Eichengreen's sociological explanation for nominal wage rigidity is correct then inflation (assuming money illusion) is a less costly mechanism for ensuring a smooth adjustment path. Furthermore, even if one discounts money illusion inflation and/or devaluation may be a less costly means of reducing real wages as it does not suffer from the protracted effect of a policy of deflation in terms of wage adjustment, which along with fixed contracts, may well

[10] Eichengreen, Brookings, October (1985).

[11] *q.v.*, the Triffin paradox.

disturb wage differentials and add a further element of downward wage resistance.

During the 1930s French economists were to argue that the failure to stabilise the franc earlier led to a massive inflow of foreign exchange between 1926-28. This was re-deposited in New York supporting and feeding the credit boom, the cause of subsequent collapse. Therefore, the adoption of a gold bullion standard by France would, by absorbing gold, help deflate this artificial credit edifice as well as restore some control over the domestic money supply.[12]

One might also mention a striking parallel between inter-war history and the asset bubble created in Japan in the late 1980s following the Louvre accord to stabilise the dollar.[13] Similarly the US under the leadership of Benjamin Strong, head of the New York Fed., loosened monetary policy both in 1924 and 1927 to support the sterling exchange, as well as for domestic policy reasons.[14] This deliberate attempt to maintain a fixed exchange

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[12] see: Aftalion op.cit., p.5.

[13] In the past few years we have witnessed a very similar process. Following the 1987 Louvre accord, and the decision to stabilise the dollar the Japanese authorities consequently lowered interest rates to shore-up the USD/Yen bilateral rate. This deliberately loose domestic Japanese monetary and credit policy caused an unprecedented domestic asset inflation which was pricked in October 1987 with the world-wide drop in stock markets. The Japanese stock market capitalisation has fallen some 60% (July 1992), whilst property prices are way down, as well as other speculative investments such as "impressionist" paintings. Lower Japanese interest rates had made US Treasury bills more attractive and Japanese savings were thus recycled in order to finance the US savings investment gap which was the cause of the ballooning trade deficits. Had these measures not been adopted it is arguable that the US authorities would have had to address the budgetary question earlier, and the trade deficit,- which is but the measure of the US savings investment gap,- would not have been so large, thus lessening trade friction with Japan.

One should note that Japanese interest rates were lowered to increase domestic absorption and reduce pressure for a stronger yen which would have squeezed the traded goods sector. But the result was only to fuel the domestic asset bubble rather than consumption. These are some of the costs of maintaining a fixed exchange rate commitment at all costs and displays some of the possible failures of policy co-ordination.

This contemporary note is injected in order to demonstrate that in banking the best asset remains, a sound historical memory. One might also add that the UK economy is still suffering from the disinflation necessary to rein-in the effects of the "Lawson boom", which was caused by a tacit fixed exchange rate commitment. The adjustment is all the more painful as the UK entered the ERM at an over-valued parity and more pointedly at a time when the UK and German economies were at different stages on the economic cycle and are now torn by different pressures, viz., the determination of the Bundesbank to control wage pressure and the degree of borrowing rather than taxation to finance reunification, whilst the UK is labouring under the worst recession in living memory. The hapless conservative government, unlike the British government in 1935, has to grin and bear as it no longer enjoys any monetary autonomy. The situation bears some, if slight, resemblance to the situation in France in 1935 when centre-right governments had no choice but to pursue a deflationary policy because of the fixed gold parity of the franc. This proved unpopular and paved the way for the Popular Front electoral victory.

[14] see Friedman & Schwartz (1963).

rate resulted in an accelerated credit bubble which burst on Wall Street in October 1929.[15] In October 1987 Wall street again collapsed when financial markets questioned the sustainability of US fiscal deficits which had helped fuel the boom. That this was allowed to happen was attributable to the Louvre policy and pressure on Japanese financial institutions to support this by absorbing significant proportions of US Treasury security auctions. This points to the possibility that managed systems or co-operation are not necessarily more "stable."

In this chapter we will track the debate concerning French monetary policy and open-market operations making extensive use of a Chatham House publication, The International Gold Problem.[16] This was the result of a discussion group convened over the period 1929-31. Its members were the most eminent economists and policy-makers of their day and the papers submitted, as well as the recorded discussion, are the best available and authoritative source from which to gain an insight and flavour of the contemporary debate. The Gold Delegation of the Financial Committee is also a useful source, membership of both groups somewhat overlapped, though the Gold Delegation Report was less forthright. This prompted the inclusion of a "Note of Dissent" in which the British view was clearly laid forth. Other sources are internal French policy statements and explanatory notes, a letter written by Governor Moret to the Finance Minister and a memorandum prepared by Professor Aftalion for the Gold Delegation. We will follow the debate closely as it is our view that it will serve to highlight the views of the French monetary policy establishment and allow us to better apprehend the course which French policy took.

The Chatham House discussion group was first concerned with establishing whether there was, or could be a scarcity of gold. D.H.Robertson alluded, in this context, to the fact that, since 1913, monetary gold had increased by some 20-40%, whilst prices and incomes had risen by some 50% and that this tendency required means of economising gold.[17] Rist, in the last paper submitted before the Chatham House discussion group,[18] argued that post-

[15] see Galbraith (1955).

[16] This will be referred to in the footnotes as RIIA (1931).

[17] see RIIA (1931) p.19.

[18] see also Rist's article in, *La Situation Economique et Financière*, 13 May, 1932, in, Ministry of Finance, B 32 316.

war prices had been dictated by prices prevailing in the sole remaining gold standard country, namely the US and that these had been artificially inflated during the period of hostilities, principally by significant gold inflows to pay for war-time supplies. Rist attributed the subsequent fall in prices to a re-adjustment and argued that the post-war price trend was therefore artificial,- *ergo*, the argument that existing prices justified a redistribution of gold was based on false premises.

As we will see the British discussants were increasingly concerned at the demise of the gold exchange standard principles which had been generally endorsed at the Genoa 1922 Conference. The French Stabilisation Law of 1928, which marked the adoption of a Gold Bullion exchange standard, constituted a rejection of the Genoa principles. Genoa had aimed at preventing a deflationary scramble for gold. In this new environment the question of international liquidity, viz., gold, became paramount. These concerns were largely to be shared by the Gold Delegation of the League.

At the outset one should point out a specific characteristic of the post-bellum gold standard, namely the disappearance of internal gold circulation. This had been a recommendation endorsed at Genoa. As a result the gold standard lost some of its automaticity (cf., Hayek), for in the pre-war world gold currency standard as credit conditions tightened and the currency fell to gold export point gold coin would be taken to the Mint and turned into bar gold or ingots reducing the monetary circulation *pro tanto*. It could be said that taking gold out of domestic circulation paved the way for the post-war credit boom as it would allow the creation of a larger credit edifice on a given supply of gold. The only constraint on credit policy would now be the ability to finance the balance of payments at the margin by means of gold shipments and sales of foreign exchange. This concentration of gold in central Treasuries in the post-bellum era is illustrated by figures submitted by Kitchin, "At the end of 1913 Central banks and treasuries held 62 per cent of the total stock of gold money, while at the end of 1929 they held as much as 92 per cent."[19]

Among discussants at the Chatham house meetings Dr. Sprague argued that there was no particular reason that reserves of 35-40% should be held against note liabilities and that reserves need only be held against potential liabilities arising out of payments imbalances. And that in practice little gold was needed as a reserve, as it was only needed to act as a

[19] RIIA (1931) p.67.

signalling device which should prompt correlated changes in credit policy, which in themselves would ensure adjustment.[20] It is clear from the latter statement that we are far removed from Hume's model of the gold standard to which French bankers still adhered. Hume's model was a purely monetarist one with a simple transmission mechanism, gold inflows and outflows having an almost immediate impact on domestic prices (cf., Friedman's helicopter metaphor), which would restore equilibrium purchasing power parity. In the model there is no place for long term capital inflows.

The view that gold should only be held for balance of payments settlement purposes was a view shared by R.Hawtrey who argued, "Underlying the whole question is this problem of what standard reserve ought there really to be - what standard of available disposable gold or gold exchange reserve ought a country to hold? I think that the answer is a simple one. There is no purpose in holding a larger reserve than the equivalent of the largest currency contraction that the public policy will allow the country to undergo."[21] Again this marks a radical departure from the pre-war gold standard view. Hawtrey admits that there is a limit to how far deflationary policy can be taken in an altered environment in which government is increasingly drawn into a more significant role and responsible for economic policy before the electorate, and nominal wages tend to inflexibility.

One of the discussants did point out that central banks had to hold reserves above the minimal ratios in order to cover balance of payments deficits, whilst still maintaining the currency backing. Again this demonstrates the radical departure from the classical text-book adjustment mechanism where a balance of payments deficit would act automatically to contract the domestic money supply. Most of the discussants saw a loss of reserves as a signal to increase the discount rate which would be the instrument which would ensure balance of payments adjustment. In such a model adjustment would take place not so much through changes in prices but, rather, through shifts in demand and consumption. The British view was probably conditioned by the far wider use of credit and cheques and its sophisticated money market, whilst the French monetary system was still overwhelmingly characterised by the use of currency notes. As we will see this different market structure would be adduced as an argument against the effectiveness of open-market policies in France.

[20] RIIA (1931) p.26. This is a "rules of the game" type of analysis (see chapter two of this thesis).

[21] RIIA (1931) p.102.

Dr. Einzig, journalist and prolific author on inter-war economic and monetary affairs, suggested that the BIS could eventually fulfil the role of lender of last resort and so reduce aggregate reserve holdings.[22] This was a hope shared by Sir Otto Niemeyer[23],- H.M. Treasury, 1922-27; Bank of England from 1927; Director of the Bank of England, 1938-52;- and Sir Cecil Kisch[24],- Kisch was Secretary, Financial Department, India Office, 1921-33; and author with Elkin of a standard work on inter-war central bank constitutions. However, none were overly optimistic about the short-run prospects of such an eventuality, neither did they take the argument as far as Keynes was to do with his Bancor plan, i.e., that countries accumulating positive clearing balances out of the proceeds of their balance of payments should be taxed on these in order to enforce a more symmetric adjustment mechanism than the deflationary and asymmetric bias of existing balance of payments adjustment mechanisms. Keynes' plan in fact amounted to an attempt to restore the theoretical symmetry of the adjustment mechanism which existed under the text-book Hume/Ricardo gold standard model.

The reason the discussants were so preoccupied with reserve ratios and means of economising gold is that it was thought that the Genoa principles, which aimed at an international gold exchange standard in order to avoid a post-war deflationary scramble for gold, had been gradually eroded. It was held that as the world was increasingly characterised by a gold bullion standard means would have to be found to economise its use, hence the suggestion that at some later date the BIS could act as a global clearing house. The view was that both the US and French gold reserves posed a serious threat to world liquidity. Kitchin was of this view and argued, "I think it undoubtedly true that the correction of the present maldistribution of gold is one means of economizing gold, and would certainly help the position."[25]

Mouré (1991) refers to P.Quesnay's (General Manager of the BIS and former Director of Research at the Bank of France) suggestion ahead of the London World Economic Conference that the creation of credit be promoted through, "concentrating gold reserves at

[22] RIIA (1931) p.102-103.

[23] RIIA (1931) pp.107-108.

[24] RIIA (1931) pp.152-153.

[25] RIIA (1931) p.74.

the BIS."[26] However, Mouré points out that Quesnay was at odds with the French delegation to the Conference on the issue.

Joseph Kitchin,- a leading business cycle theorist,- argued that to give a fairer view of France's gold holdings one had to look at both gold held at the central bank and in circulation before the war, and compare it with current central bank reserves. To compare Bank of France reserves in 1913 with those currently held would tend to overstate the increase as gold was now concentrated in the central bank compared to pre-war. However, Kitchin recognised that according to his figures French gold holdings were still £74 millions sterling higher than the combined holdings of both Great Britain and Germany.[27]

Amongst features of French policy which came in for criticism was the Bank of France's 35% cover ratio which, it was argued, was arbitrary,- though based on past UK prudential ratios.[28] As we have seen many of the discussants urged that gold be only held against potential foreign liabilities and only to the extent to which the authorities would be willing to deflate in order to restore equilibrium, rather than devalue - the latter point is no where explicitly made, but is implicit. An additional feature of the 1928 Stabilisation Law, which in the minds of many of the participants ought to have been altered, was the obligation on the part of the Bank of France to hold gold against the combined note and current account deposit liabilities. Again Rist,- economist, Professor and honorary deputy-Governor of the Bank of France,- was to argue that banks had to hold liquid assets against any contingent liabilities and that this was a sound banking principle learnt from the British. Hawtrey chided Rist for his determination to take the British at their word.

Quoting Hawtrey, "The French have been taught, partly by the Anglo-Saxons, that to hold government securities against the note issue is contrary to sound banking. We and the Americans must admit that we do not carry that into practice, but if you refer to the text-books you will find that it is laid down as a rule, and the French have conformed to it. They have no government securities, except to an insignificant amount against their note issue. What has taken place their place? They went on buying dollar bills and sterling bills up to a very large amount, but eventually they became frightened. As Sir Otto (Niemeyer) has

[26] Mouré (1991) p.101.

[27] RIIA (1931) p.78.

[28] see Rist's paper in RIIA (1931).

pointed out, there are psychological objections to a gold exchange standard, and people do not like to hold the backing of their note issue entirely in foreign securities. The French raised the total of their funds in foreign securities to thirty-two milliards, or £250 millions. They thought it was too large and so they proceeded to reduce it, but even now it is twenty-five and three quarters milliards, or over £200 millions. They had then to fill the gap, which had to be made good in some way. The supply of rediscountable bills in France was quite insignificant in comparison to the amount of backing which was required, and so they had to have gold, as there was nothing else to fill the gap."[29]

According to J.H.Penson the swollen reserves of France and the US spread deflation across the exchanges.[30] With reference to the gold exchange standard one should remember the potential for significant losses on foreign exchange holdings, a point which R.H.Brand,- a Director of Lazard and member of the Committee on Finance and Industry 1930-31; and member of the Advisory Committee on Financial questions 1931-32,- was to make.[31] In the event, France was to lose some 2.3 *milliards* francs on its sterling balances following sterling's devaluation.[32]

Niemeyer, however, rejected the suggestion that gold ratios be altered as this was likely to undermine confidence in the currency. One had but to recall the effect which raising the fiduciary issue from £14 millions to £15 millions sterling in 1931 had in undermining confidence in sterling. "I feel, therefore, that particular method, the method of altering ratios, if one were driven to it, and if one thought it were sound in itself, does present very great practical difficulties." Niemeyer felt, most certainly correctly, that it was a pity that the UK was the most ardent promoter of the gold exchange standard as, "It has come for good or evil to be regarded increasingly as a British fad, and in some quarters on the Continent even as a nefarious plan to put Europe under the financial heel of London..."[33] Niemeyer is of course alluding to the French opinion in this regard which was

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[29] RIIA (1931) p.100.

[30] RIIA (1931) p.108.

[31] RIIA (1931) pp.173-174.

[32] see Sandoz (1936).

[33] RIIA (1931) p.91.

particularly nurtured by Bank of France Governor Emile Moreau.[34]

This is a view shared by D.Traynor who has argued that the resolutions of the Cannes "Conference" (meeting) held in January 1922, which prepared the Genoa Conference held in May, conformed largely with British interests, "In these resolutions, which are only a slight modification of those proposed by Lloyd George, the expression of the British need is apparent."[35] These resolutions called for credits to weak countries and the resumption of trade and adequate means of exchange. "General as these suggestions may seem, and applicable as they were to the continental situation, they are none the less obvious expressions of British policy and of British nationalism."[36] Moreau would have concurred.

Commenting on a somewhat later period but, nonetheless, pertinent L.Germain-Martin, Finance Minister on several occasions during the mid-1930s, had argued that the UK view was that international transactions could only be restored if Germany were to prosper.[37] This suggests the source of some of the conflict during the early 1920s with France approaching the problem in part from a view to its national security. It hardly need be pointed out that renewed German prosperity was not a foremost objective of French policy-makers, particularly Poincaré.

However, Niemeyer argued that, "the gold exchange standard is emphatically not protective colouring for Great Britain,"[38] but only a means of economizing gold to everyone's ultimate benefit and that such a policy distributed the international benefits derived from increased international reserves. However, the French would have emphatically disagreed on the grounds that it established a hierarchy of central banks with those on gold setting world credit growth, whilst others had to absorb gold centre liabilities (viz., notes) and hold them as assets against their note issue. This view was long a constant in the French economic policy-making establishment and was to be the basis for de Gaulle's attempts to

[34] see Moreau's memoirs.

[35] Traynor (1949) p.71.

[36] Traynor (1949) p.71.

[37] Quoting Germain-Martin (1936), "*Outre-Manche, on estime que l'activité des transactions internationales, nécessaire à la prosperité du Royaume Unie, ne pourra reprendre que si l'Allemagne redevient une nation prospère.*" p.30.

[38] RIIA (1931) p.91.

subvert the dollar based Bretton Woods system, which afforded the US an "inordinate privilege," and the ability to finance its budget deficits automatically as member countries absorbed dollars to maintain their exchange parities against the dollar.[39]

Niemeyer also usefully highlighted the argument adduced by many French policy-makers as well as French and "Austrian" economists, namely that the gold exchange standard was inherently inflationary, as it allowed the growth of a pyramid of credit on a fixed gold base, using the foreign exchange of gold currency countries as a proxy for domestic gold. Quoting Niemeyer on the gold exchange standard, "to that I think perhaps one ought to add the more technical criticisms which have been made of the gold exchange standard, more particularly in the United States - the argument that the gold exchange standard is necessarily inflation, because it means that the same gold functions twice over, once in the country part of whose reserve it is, and once in the country where it is held, where it enters into the monetary structure of that country, so that on the same actual gold two bases of credit are erected."[40] This view was held by v.Mises, v.Hayek, M.Rothbard and implicitly by C.P.Kindleberger who argued that monetary instability was due to the lack of a financial hegemon and that this caused currency instability between financial centres and contributed to the collapse into competitive deflation.[41]

Eichengreen has taken issue with Kindleberger's hegemonic stability thesis, arguing that cooperation has characterised most monetary regimes,[42] though this does not invalidate Kindleberger's argument which rests, not only on the lack of a single hegemon or vehicle currency, but also on the uncooperative nature of the reconstructed post-war financial regime by the late 1920s.

The collapse of sterling in September 1931 would tend to prove Rist's point that the gold exchange standard was inherently unstable and that it allowed a pyramiding of credit which could lead to liquidity crises and undermine national monetary systems, or at least confirm Eichengreen's point that given the altered nature of the inter-war balance of

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[39] It is worth noting that French international hegemonic monetary designs have altered little with its determined, and so far successful, drive to take control of German monetary policy under the cloak of European integration (q.v. the 1991 Maastricht accord).

[40] RIIA (1931) p.91.

[41] see chapter two of this thesis.

[42] see Golden Fetters.

payments, co-operation and balance of payments surplus recycling was essential.[43] When the Macmillan committee report appeared, as the financial and banking crisis swept Europe, the figures published revealed large immobilised British balances and outstanding short-term liabilities which undermined sterling.

R.H.Brand had warned of these potential dangers, "I am bound to say, however, that I myself feel that this system (i.e., the gold exchange standard) leads to certain dangers. It would be all right if we had an international institution accepted by all parties where these reserves were kept, and which acted as a sort of clearing-house; but if the nations working this system are to use certain centres - say, London and New York; let us consider particularly London - where they keep a large part of their reserve as sterling deposits, then obviously that system might under certain conditions put an immense strain on the London money market, and on the Bank of England, particularly when the amount of those deposits, and therefore the amount of the claims upon our reserves, is not known. We should, I suppose, if we treated these deposits really as gold withdrawn from use, make provision at the time for meeting them; but at present we act as if it is unnecessary to make any further provision owing to the fact that other countries leave huge deposits with us as part of their reserves which they are entitled to draw at any moment."[44]

The collapse of sterling due to its over stretched financial commitments, failure of deflationary policy and attendant political crisis does, from a French perspective, tend to corroborate the view that the British argument in favour of the gold exchange (sterling/dollar) standard was an exercise in special pleading and an attempt to salvage the City's dominant pre-war financial position.

The discussants were also unclear as to whether there was an immediate scarcity of gold. However, amongst the mainly British participants there was virtual consensus that there was a considerable maldistribution of gold which had exacerbated the international adjustment mechanism.

Quoting Niemeyer, "I should feel inclined to say at the present moment that there is not an actual shortage of gold in the world, but there is a bad adjustment in the supply which

[43] The alternative policy would have been floating exchange rates and a policy to stabilise the internal purchasing power of currencies. However, in the prevailing intellectual climate and the unfortunate post-war experience with floating exchange rates and hyper-inflations this alternative was out of the question.

[44] RIIA (1931) p.173-174.

exists."[45] Strakosch attributed the drop in world commodity prices to the accumulation of gold in the US and France. "During 1929, there became available something like £65 or £70 millions sterling of fresh gold, whereas the United States and France in that year absorbed no less than £110 millions sterling of gold. As every one knows, any gold which goes into the Federal Reserve system, and any gold which has gone into the Bank of France since the end of 1928, is no longer monetary gold. They do not build a structure of credit on it. The effect of the gold movements in the last year was not only to withhold from the rest of the gold standard world their share of the new production, but also to pull out of their reserves something in the neighbourhood of £35 to £40 millions. That alone is sufficient to explain the catastrophic fall of commodity prices which took place towards the end of 1929."[46]

The report of the Gold Delegation of the League of Nations points to this increased concentration of world monetary gold reserves, "At the end of June 1931, over 60 per cent of the central gold reserves of the world (apart form the U.S.S.R.) were in two countries - the United States of America and France."[47] The view of most French commentators was that the depression had been caused by weak commodity prices which had dropped because of post-war over-production and not to a putative maldistribution of gold.

However, quoting the Quarterly Review of Business Conditions, "If these views are correct (those of Sir H.Strakosch), America and France, by their monetary policy, have thus unwittingly inflicted widespread depression. In America, sterilisation of gold has been produced, not by any obstacles placed in the way of granting credit or parting with gold. There credit can be granted even more simply than in London, for the member banks rediscount directly with the Federal Reserve banks. Sterilisation came about by the immense claims that America earned upon the rest of the world by sales of goods at high prices during and after the war, which claims the debtors had to meet, in part, by sending gold, being prevented by the stiff American tariff from liquidating them by shipment of goods. The Federal Reserve system has thus acquired a stock of gold more than double the amount required by law to support its liabilities on notes and deposits. When it endeavoured to effect a redistribution of this excessive stock, by making money cheaper in America than

[45] RIIA (1931) p.93.

[46] RIIA (1931) p.95.

[47] Report of the Gold Delegation of the Financial Committee, L.N. (1932), p.37.

elsewhere, its effort was defeated by the immense growth of speculation which produced high rates in Wall Street which brought more gold in from outside. Since this speculative fever died down the Reserve banks have taken measures, by purchases of bills and securities, to neutralise exports of gold and discourage imports. France would probably do the same, if it could, but owing to its monetary system such remedies cannot be employed. It is, surely, more than high time that this monetary system should be reformed by more practical and effective methods than have hitherto been employed."[48]

The author of this article well represents Strakosch's argument, however the suggestion that, in 1930 when the article was written, France would have engaged in open-market operations had it been permitted to do so is very unlikely as the statements of Rist, Moret, and Aftalion bear witness. And as we have seen it is our view that such a policy might have undermined the credibility of the Bank and currency.

The above quote is also interesting because it highlights the extent to which capital flows could already swamp/offset the expected automatic adjustment mechanism which a loosening of credit policy was expected to set in-train, i.e., a relaxation of credit policy led to a capital inflow precipitated by bullish sentiment (cf., Nurkse) which was premised on an expected appreciation of asset values and earnings. This leads to speculative bubbles and one-off "equilibrating" adjustments such as the October 1929 crash, i.e., markets in practice often appear to act discontinuously.[49] In the classical gold standard model a relaxation of policy should lead to a rise in price, a current account deficit and gold outflows, and opposite effects in the other country (positing a two country model) until a new equilibrium is restored through a smooth adjustment path. One should note the absence of capital movements. Their introduction alters the model radically.[50]

Another issue raised resulted from the proportional or fractional reserve system as practised in both the US and France. This was the so-called "free gold" problem.[51] Only gold and real bills could satisfy the criteria set for eligible reserve assets. This had perverse effects, for as economic activity declined so did the number of real bills presented for

[48] "The French Demand for Gold," in, Quarterly Review of Business Conditions, (1930), p.7.

[49] *q.v.*, the October 1987 crash.

[50] see chapter two of this thesis.

[51] see Rothbard (1983); and Eichengreen Golden Fetters.

discount and, therefore, for any given number of outstanding notes in circulation the required level of effective gold reserves would need to increase *pari passu*.[52] As a result the "free" monetary base would fall and exacerbate deflationary forces.[53] Eichengreen points out that the free gold problem, which effectively meant that given a shortage of eligible real commercial bills the banking system's effective gold reserve requirements rose, meant that the money multiplier associated with open-market policies would be reduced.[54] This was more of a US problem. However, large French Treasury deposits at the Bank of France required backing as they were included in sight liabilities against which reserves had to be held. The *Caisse des Dépôts et Consignations*, which managed funds on behalf of postal and popular savings banks, kept 10% of its assets in cash deposits at the Bank of France which also had to be backed. The "*Caisse*" was no small player, its assets in 1937 totalled 106bn. francs.[55] The provision that reserves should be held against Bank of France sight liabilities, thus adding to France's demand for gold, would come in for criticism.

The essence of the "free gold" problem is best captured in the following quotation from D.H.Robertson's contribution to the discussion, "...the statement which is constantly made by American authorities that the real obstacle to the re-distribution of gold is not their 40 per cent. law - it clearly is not that - but the remaining provisions of the Act which prescribe the nature of the assets which the Federal Reserve Bank has to hold against that part of their note issue which is not covered by gold. They say, in fact, they are as strictly bound by the law as if they had a fixed fiduciary issue, because they have to hold eligible paper against the remainder of the notes, and there simply is not enough eligible paper about to enable them to increase their note issue or to dispense with the gold which they at present hold against it."[56]

The "free gold" problem did not occur in the British system with a fixed fiduciary issue, notes issued above the prescribed fiduciary issue were effectively backed 100% at the margin. In this context it should be remarked that given the potential for cumulative

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[52] see Friedman & Schwartz (1963).

[53] Hawtrey's evidence in RIIA (1931) pp.99-100.

[54] Golden Fetters, p.296.

[55] see Laufenberger (1940).

[56] RIIA (1931) p.161.

deflation in a system based on a fractional reserve it could be argued that it was just as well that French reserves were above the mandatory limit in order to provide a cushion against the need for cumulative credit deflation in the face of a gold outflow. Though if France had had lower gold reserves the political cost and ineffectiveness of deflation *à outrance* would have forced France off gold earlier and could therefore have had a salutary effect.

Rist rejected the thesis that there was a direct correlation between gold holdings and deflation,[57] pointing out that deflation had spread from the US which held the world's largest gold reserves. Rist's view was that the post-war price structure was artificial from the beginning and that a correction was inevitable. He rejected the implicit and often explicit suggestion that France deliberately absorbed gold. The Bank of France was merely acting within the legal provision of the stabilisation law of 1928, and the Bank was precluded from engaging in open-market operations. This view was shared by Dr. Palyi who was the economist of Deutsche Bank in Berlin, "I am not certain whether it is safe to criticize the "misbehaviour" of this note bank with regard to gold accumulation, since its last yearly report expressly states that it only bought gold when it was offered to the Bank. As a matter of fact, it is the very meaning of the gold standard that some central authority should always be ready to buy and to sell gold at prices fixed within narrow limits. I am not aware of any facts which would disprove the contention of the Bank of France; the balance of payments of France ought to have been in the last two years very "advantageous" in view of reparations and of repatriation of previously exported capital, and consequently it is not surprising at all that gold was flowing to a large extent to the central institution of that country."[58]

Hawtrey and most discussants, e.g., Henderson accepted that French policy was not deliberate,[59] but argued nonetheless that something could be done about it, either by lowering France's reserve ratios, or, failing that, engage in offsetting open-market operations. Otherwise, quoting the Hon. R.H.Brand, "... under the conditions under which

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[57] see also Aftalion's paper submitted to the Gold Delegation, in, Ministry of Finance B 32 316, p.11.

[58] The International Gold Problem, p.130. Some 40 years later Palyi (1972) published a book entitled: The Twilight of Gold, advocating a return to the gold standard. He continued to maintain, the then very unfashionable opinion, that the depression had been caused by the inflationary boom of the 1920s. The boom having been caused by the failure to adhere to the rules of the gold standard. Lord Robbins had by then recanted his earlier Hayekian views.

[59] RIIA (1931) p.215.

the Bank of France works, and under the laws of France, it may be impossible for the Bank of France at this moment to do anything but sit down and see its gold accumulate."[60] Which is exactly what happened during the so-called "gold avalanche" period 1928-32. This was exacerbated by provisions, in the 1928 Stabilisation Law, precluding the Bank of France from increasing its foreign exchange reserves above existing levels. Nonetheless, even if the latter provision had not existed it was unlikely that the Bank would again be willing to take the risk of running large foreign exchange losses.

R.Nurkse was also damning as far as the consequences of France's gold imports was concerned, and blamed them for the downfall of the inter-war international financial system, "The fate of the gold exchange standard was sealed when France decided in 1928 to take nothing but gold in settlement of the enormous surplus accruing to her from the repatriation of capital and from the current balance of payments. The French gold imports certainly aggravated the pressure of deflation in the rest of the world and especially in London. In London, the pressure became unbearable in the end, and the gold parity of the pound was abandoned."[61]

The French view was that the collapse of sterling was in great part due to open-market policies and other attempts to impede the natural workings of the market (e.g., unemployment benefits, vide, J.Rueff).[62] A paper prepared by the Bank of France in 1933 argued along these lines, viz., that the UK had brought devaluation on itself by engaging in open-market policies which had prevented the "natural" adjustment which a gold drain would have brought about. Sandoz (1936) distinguished between the Bank of France's policy which was "passive" based on the discount of sound commercial bills, and an "active" open-market policy which he dubbed, pejoratively, "planist."

According to Hawtrey, France absorbed gold after stabilisation because the real money supply was too low and the only way that economic agents could reconstitute their

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[60] RIIA (1931) p.156.

[61] see Eichengreen (1985), The Gold Standard in Theory and History, abridged article by R.Nurkse, p.213.

[62] Quoting from a Ministry of Finance paper on open-market operations, "*Note sur l'Open Market Policy*", B 32 323, dated 23 May 1933, "*En suivant cette politique, la Banque d'Angleterre n'a pas permis aux sorties d'or d'exercer leur influence sur le volume de la circulation et le niveau des prix. Elle a favorisé la spéculation à la baisse de la livre sterling car elle a évité le resserrement monétaire qui, seul, pouvait entraver les opérations de la spéculation. Cette politique a été en grande partie, responsable de la chute de la livre sterling.*" *op.cit.*, p.3.

real cash balances was by running down foreign balances built up during the early 1920s, and realising the proceeds arising out of the favourable current account balance. This would translate in an inflow of gold as the Bank of France could not issue currency against foreign exchange. On the official settlements side gold inflows were connected with reparations payments. Other commentators alluded to the large foreign balances acquired by domestic agents throughout the early 1920s when the franc was weak, as well as the profits realised by domestic agents on foreign exchange transactions in the run-up to the Poincaré stabilisation.[63]

Quoting Hawtrey on the reasons for the inflow of gold into France, "I remember pointing out when the French stabilization first began in April, 1927, that the then note circulation of 52 milliards was extremely inadequate. Taking the estimates of the pre-War circulation of notes, gold and silver in France - the total monetary circulation in France before the War - it was quite clear that with the price level adopted for stabilization they would need something like 70 milliards of notes in order to maintain monetary equilibrium. If people are short of currency, that means that their purchases of goods, including their purchases of imports, fall off. Then you get a favourable balance of trade. The favourable balance of trade is the effect of a shortage of currency. It is a process by which the desire of individuals to hold a greater quantity of currency is translated into an import of gold - the only instrument by which their desire can be satisfied. The chain of causation runs through restriction of expenditure, restriction of imports, a favourable balance of trade, importation of gold, sale of gold to the Bank of France against notes, and thus an ultimate increase of currency. The whole of that process could be quite easily interfered with if the French legislature so desired and the Bank of France took action accordingly - simply by buying securities - say, French Rentes - and issuing notes against them. The gap that had to be filled by the acquisition of foreign exchange and gold in the early stages of stabilization was caused by the paying off of the debt by the government to the Bank of France. A gap of something like 40 milliards was made in the assets of the Bank of France at that time, and at the same time, as I have pointed out, the note issue was short of requirements. The importation of gold and the acquisition of foreign exchange have been required to fill that

[63] see: Quarterly Review of Business Conditions, July 1930, in, M.F. B 32 316.

gap."[64]

His reference to the reduction in the Treasury debt to the Bank of France indicates that Hawtrey took it at face-value. Eichengreen reproduces this misapprehension.[65] However, this was only an accounting exercise resulting from the profits realised on the revaluation of the Bank's gold, - the note circulation was not affected. The earlier François-Marsal convention which did aim at reducing the real outstanding Treasury balance was not even fully met. Hawtrey's statement can only make sense if he means that the profits realised on the Bank of France's gold reserves should have been fully monetised, rather than part devoted to closing the overdrawn Treasury account at the Bank of France.

Hawtrey's statement is very interesting because it clearly puts the case against France whilst suggesting the most appropriate remedial action, viz., open-market policies. Hawtrey's paper explicitly attributed France's balance of payments surplus to what is now known as the monetary theory of the balance of payments, with the mechanism running from the desire on the part of individuals to reconstitute real cash balances (the level of real cash balances desired appears akin to Keynes's k).[66] Hawtrey's analysis conforms, to a singular degree, with the McCloskey & Zecher thesis.[67]

Hawtrey's policy prescription runs up against the policy dilemma identified by M.Friedman, viz., the need to convince economic agents that an increase in the money supply at the end of an inflationary period is aimed at satisfying the demand for increased real cash balances, in order to avoid a further deflationary twist (as the velocity of circulation drops), rather than a signal of monetary relaxation. This was resolved in France, in the period 1926-28, as the notes created above the mandated ceiling were 100% backed by foreign exchange or gold, i.e., the currency so issued was at the margin fully backed "outside" money.

[64] RIIA (1931) pp.157-158.

[65] Eichengreen (1990) p.94.

[66] viz., Hawtrey's monetary theory is premised on a behaviouralist model, as opposed to the Hume/Ricardo/Friedman model which leaves the monetary transmission mechanism ill-defined - hence, the helicopter metaphor. The transmission mechanism in Hume (1875) is clearer because he assumed specie circulation and fixed exchange rates, though in his essay on "The Balance of Trade" Hume asks us to imagine that the currency in circulation halves or doubles overnight.

[67] see chapter two of this thesis.

Hawtrey's statement conformed with his desire to maintain a constant price level. He was keen to point out that since 1919 he had argued for stabilisation of the monetary unit "in terms of human effort."[68] In the US Irving Fisher was lobbying towards a similar objective, viz., a currency with a constant purchasing power.

Hawtrey also argued that the requirement that reserves be held against current account deposits meant that the large Treasury deposits at the Bank of France forced it to maintain larger than necessary reserves. He put part of the blame for this on France's attempt to live without a floating debt, which in the UK was used to cover seasonal revenue shortfalls in order to finance government expenditure.[69] However, in France since the 1920s floating debt had become synonymous with inflation and currency depreciation. In fact though Hawtrey does present a cogent case, apportioning the blame for the weakening of the international monetary system on the maldistribution of gold, his policy prescription fails to appreciate the impact of the historical legacy in the national psyche of the experience with currency instability in France before the Poincaré stabilisation. Had the Bank of France requested that its statutes be modified in order to engage in aggressive open-market policies this would have been considered a precursor to inflation and turned market sentiment against the franc and undermined the Poincaré stabilisation. Eichengreen (Golden Fetters) and Mouré (1991) concur with this judgement.

W.Newbold argued that the problem of maldistributed gold supplies was compounded by France's failure to re-cycle its surplus, thus effectively sterilising international liquidity and, given the fundamental asymmetry in the international adjustment mechanism which places the burden of adjustment on the deficit country, helped spread deflation. Newbold argued that the previous unhappy experience with foreign lending was responsible for the lack of enthusiasm for foreign investment on the part of French savers.[70] J.M.Keynes also stressed the need for renewed foreign lending.

D.H.Robertson sounded a note of caution on the question of altering reserve ratios or open-market policies, and he actually came close to endorsing Rist's view that far from being equilibrating a relaxation of prudential requirements or open-market policies might

[68] RIIA (1931) p.38, referring to views expressed in, Hawtrey (1978).

[69] RIIA (1931) p.158.

[70] RIIA (1931) p.154-155.

compound the difficulties of adjustment. "...I have an extreme scepticism whether, in the present condition of affairs, any alteration of laws is going to make it any easier to effect this re-distribution of gold. I think that the Federal Reserve authorities have done their best, but when they try to inflate and to raise prices and to lose gold and to make things easy for us, all that happens is that they create a Stock Exchange boom which lays up more trouble in the future. I think the matter of producing a rise in world prices is much more difficult than one is often told by those who lay the whole blame upon under-production, or alleged maldistribution of gold."[71]

Robertson's argument has a great deal of immediacy about it for a commitment to stabilise the dollar under the Louvre accord of 1987 precipitated a huge asset inflation in Japan which resulted from interest rate reductions aimed at maintaining the semi-fixed dollar/yen exchange parity and increasing domestic absorption.[72]

Robertson also pointed out that figures submitted by Kisch on central bank gold holdings demonstrated that reserves were in most cases far higher than mandated which belied the contention that there was an immediate shortage of gold, Dr. Palyi shared this view.[73] However, Robertson does not live up to the strength of much of his economic thinking which tends to be dynamic in nature. For it could be argued that the effort to constitute large gold holdings partly explained falling gold prices (i.e., a rise in the purchasing power of gold). It is only when a static view is taken that it might appear that real gold stocks are high. This view was shared by Hawtrey who argued in reply to Palyi, "That past competition for gold has had the effect of reducing the world price level. It has had the effect of leading each country in turn to contract credit and to contract its money supply for the purpose of bringing about an import of gold. Those contractions of credit have directly caused an appreciation of the monetary unit of the country concerned. Each in turn having done that, all the monetary units have appreciated, that is to say, gold itself has appreciated in terms of commodities. I think that accurately describes what has happened, and the existing plenty of gold is merely the result of that competition for the supply of gold after it has worked its effects on the currencies of all those different

[71] RIIA (1931) p.162.

[72] Similar reasoning can be found in, <u>Quarterly Review of Business Conditions</u>, July 1930.

[73] RIIA (1931) p.122.

countries."[74]

The views expressed by most discussants within the Chatham discussion group were largely echoed in the "Note of Dissent" appended to the League of Nations Financial Committee report. This was of course in no way coincidental, as Strakosch was a major contributor to both, and the Chatham House discussion group acted as a parallel informal forum in which views could be aired.

The Gold Delegation Report had been commissioned in order to determine the causes of fluctuations in the value of gold. The report did appear to indicate a change in emphasis if one compares it with the Bruxelles and Genoa conferences.[75] In the Gold Delegation Report there was a far greater emphasis, than there had been a decade earlier, on domestic policy and international co-operation and consultation, in order to ensure that different policy objectives did not lead to beggar-thy-neighbour (and thyself) policies. There was also an emphasis on the intrinsic link between trade and monetary policy. An awareness of the political dimension to monetary stabilisation, both domestic and international, was also far more manifest in the main body of the report, though on the whole it did not really say anything new. However, there was substantial stress on the need to come to terms with war debts and reparations as well as some lasting political settlement,[76] though it still recommended that gold be the basis for any future international monetary system.

[74] RIIA (1931) p.122.

[75] Quoting Traynor (1949) referring to the conclusions of the Bruxelles Conference of 1920, "There was, for instance, practical unanimity concerning the advantage of returning to the gold standard, if not at once, at least as soon as that could be done without too great deflationary repercussions. The fact that this proved a remedy beset with more disadvantages than benefits indicates mistaken ideas about the changed financial situation of the world and a want of experience or insight rather than of good will." p.65.

However, the Bruxelles Conference was more concerned with recommending fiscal prudence and budget balancing than an immediate return to gold (i.e., securing the fundamentals rather than first re-establish the gold standard as an expectational anchor) and warned against the deflationary risks of returning to par for currencies which had significantly depreciated. Quoting Traynor (1949), "Under the existing conditions the committee did not advise either the stabilization of the value of gold or the fixing of ratios between fiduciary currency and the nominal gold value. For at least the second of these objectives, economic stabilization was prerequisite." p.59.

[76] "Reparation and war debt payments had, in fact, laid such an enormous burden on the gold-standard system of the world that it was impossible for this system to carry, and therefore the system had to break down." From Report of the Gold Delegation of the Financial Committee (1932), p.66.

"We do not wish to enter into the political aspects of this problem; but we do desire to record our conviction that, without some measure of political settlement leading to renewed confidence in international economic and financial relations, there can be no secure basis for the restoration and improvement of world trade and finance." *op.cit.*, p.57.

The "Note of Dissent" was particularly forthright in pinning the blame for destabilising the international system on France. The majority report was not without levelling implicit criticism, "The financial stringency thus created in the borrowing countries was accentuated by the fact that in this period, and particularly after the stabilisation of the franc, there was a strong movement of short-term balances back to France,"[77] and it argued that in order for the gold standard to operate effectively, "... in connection with a general and effective restoration of the gold standard, a modification of the present distribution will be required."[78]

However, the "Note of Dissent" adopted a far more strident tone and it is hardly surprising that it was not incorporated in an official document, "In fact, the gold price level was fairly stable in the period 1925-1929. After 1928, however, a situation arose in which by far the greater part of the new gold available became concentrated in two countries, while the remaining countries of the world, apart from the U.S.S.R., so far from increasing their stocks of monetary gold, lost no less than 16 per cent of their monetary gold between January 1st, 1929, and June 30th, 1931."[79]

"It is clear from the figures given above (figures for increased gold reserves over the period 1/1/29 to 3/6/31, France +74%, U.S., +19.5%, rest of the world excluding U.S.S.R., -16%) that the recent drastic fall in prices has been caused by a maldistribution of monetary gold rather than by any shortage of the world's monetary stocks of gold as a whole."[80] The authors of this note attributed this to large surpluses on balance of payments, due amongst other things to reparations and war debts. Until 1928 this surplus was lent on long term by the US and short-term by France, but when the flow ceased debtor/deficit countries had to export gold.

"To put the matter very briefly, we hold that the fall in the general level of prices has been the fundamental cause of the present depression, and that the fall was the result of the obligation to pay reparations and war debts combined with the unwillingness of the receiving

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[77] Report of the Gold Delegation of the Financial Committee (1932), p.21.

[78] Report of the Gold Delegation of the Financial Committee, p.38.

[79] Report of the Gold Delegation of the Financial Committee, from: "Note of Dissent", appended by A.Janssen, R.Mant, and H.Strakosch, L.N. (1932), p.65.

[80] "Note of Dissent" to Report of the Financial Committee, L.N. (1932), p.65.

countries to accept payments in goods and services, so that payment had to be made in gold."[81] This takes us back to the dispute over reparations,- and we know that the UK and France had been at odds over the issue,- as well as the perennial "transfer" problem.

This analytic and policy rift between France and the UK is substantiated by Drummond who avers that, "In the early 1930s it was widely believed that price declines had caused the Depression, either wholly or in part"..."Long before the World Economic Conference opened in June 1933, Chamberlain and the Treasury officials were persuaded of its truth. Their comments and their proposals reflected their conviction and were influenced by some of the diagnoses that connected price decline with the malfunctioning of the gold standard - in particular, with the accumulation and sterilization of gold by France and the United States."[82]

Hawtrey, Strakosch,[83] and Cassel all subscribed to this view.[84] Drummond

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[81] "Note of Dissent" to Report of the Gold Delegation, L.N. (1932), p.67.

[82] Drummond (1981) p.127.

[83] An article written by Sir Henry Strakosch for the Financial News on 12/11/36, entitled "Fewer trade bans from devaluation," lends a particular insight into his views on the causes of the depression. This article was published following the Blum devaluation of September 1936. Strakosch was of the opinion that the Gold Bloc had set itself an impossible task pursuing deflation as it did in a democratic framework. The British attitude had been bred of its painful post-war experience, which the British political establishment was committed not to repeat.

Paradoxically, France which is often condemned for its putative in-bred cultural mercantilism had remained wedded for much of the inter-war years to Manchester liberalism.

Quoting Strakosch on the causes of the depression, "The real explanation of the depression, and, with it, of the breakdown of international trade, was unquestionably the steep and rapid fall in the level of commodity prices. The fall had the effect of reducing so substantially the money incomes of the community that the burden of debt and of other fixed money obligations had become overwhelmingly oppressive." This had prompted debtor countries to introduce measures aimed at preserving the balance of payments by reducing imports, raising tariffs, quotas, etc... "But, as I have already said, if most countries pursue the same kind of policies in this respect it is bound to fail - as indeed it has failed." As he attributed growth in part to trade and the increased division of labour here lied one of the major causes of the depression.

And on the economic and political problem of deflating in a world increasingly characterised by fix nominal wage costs Strakosch would comment, "The experience of the Gold Bloc countries provides convincing proof that the many rigid and semi-rigid items in the present-day cost structure cannot be reduced by deflationary measures to an extent sufficient to bring them into harmony with the level of prices if that level has fallen substantially and rapidly. These countries failed to realise that their rigidity is in fact part of our modern civilisation, and that any attempt at a drastic reduction has a profoundly disturbing effect on the social and political order, because it involves a progressive debasement of the standard of life."

Referring to the Gold Bloc countries after the serial devaluations in 1936, "They are no longer seeking to redress the disequilibrium between their level of costs and prices by measures directed to deflating costs, but by the very method which has proved so successful in the sterling countries."

"Devaluation will have the effect of raising the level of commodity prices in those countries, but that rise will not, I am confident, entail a corresponding rise in the cost of production."

"And, finally, there must be a clear recognition of the fact that creditor countries cannot expect debtor referred to Cassel as, "perhaps the most influential theorist on trade and currency during the 1920s and early 1930s."[85] Drummond argued that the British Economic Advisory Council was Strakoschite.[86] Strakosch was one of the leading lights of the League of Nations Financial Committee which, Moreau had forcefully argued in his Memoirs, was but a pawn of the Bank of England and British foreign policy interests.[87]

And Drummond added, "By 1931; therefore, the Treasury officials had begun to accept the interpretation that traced the world's economic ills to the maldistribution of gold. It followed that the world could not have the gold standard or even stable exchange rates without gold convertibility until it had rid itself of the structural features that had produced the maldistribution."[88]

As to policy prescription it was clear that the British view, encapsulated in the "Note of Dissent", appended to the Gold Delegation Report, was seriously at odds with the views of the French monetary establishment. This is clear if we look at the conditions which the "Note of Dissent" argued were prerequisite to an orderly restoration of the international financial system, "Such a restoration would, at any rate, require the fulfilment of a number of essential conditions, among which the following should be mentioned: a great reduction

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countries to discharge their liabilities unless such creditor countries are prepared to accept payment from their foreign debtors in goods, services or securities."

With the latter paragraph were are back to the perennial transfer problem. Strakosch's economic analysis of the intractable problems confronting the Gold Bloc are close to our own. Supply-side cost rigidities, particularly of nominal wages translate in negative (volume) demand shifts for labour, i.e., unemployment, which in turn precipitates an indirect fall in demand compounded by a policy induced fiscal squeeze caused by self-defeating attempts to balance the budget. This perverse pro-cyclical deflationary macro-economic stance merely serves to further depress demand and is accompanied by falling prices. A falling price level has the effect of raising the real burden of nominal costs, particularly wages and debt service costs (see I.Fisher). The real rate of interest rises and so does the requisite return on capital to make an investment worthwhile. In this context monetary policy on its own soon becomes relatively ineffective as nominal rates of interest cannot fall below some 2% (see J.M.Keynes, The General Theory). Only a relaxation of the aggregate macro-economic stance once the exchange rate constraint had been removed, following devaluation or suspension of the gold standard, could lift these countries out of the deflationary and interventionist morass which too dogmatic a commitment to economic liberalism (which had become equated with a fixed gold parity) imposed.

[84] see the "Note of Dissent" appended to the Gold Delegation Report and RIIA (1931).

[85] Drummond (1981) p.129,- Cassel is also the father of the purchasing power theory of exchanges.

[86] Drummond (1981) p.131.

[87] see Einzig's biography of Montagu Norman.

[88] Drummond (1981) p.133.

in the value of gold, a radical redistribution of the world's gold reserves, the resumption of a systematic gold economising policy, cancellation of all claims on reparations and war-debt payments, definite guarantees against repetition of such extraordinary demands for gold as have occurred during the last few years and, finally, restoration of a reasonable freedom of international trade and of international capital movements."[89]

The policy goal was therefore reflation (i.e., raise gold prices - lower the purchasing power of gold - and lower real debt burdens). As we saw in chapter six these differences became evident at the World Economic Conference of 1933 with the British arguing for stabilisation after prices had risen, whilst the French argued that prices would only stabilise once currencies had themselves been stabilised. "In our view, the prime need of the world to-day is a concerted policy of expansion by the principal gold-standard countries, and we see no reason whatever to fear that such a movement may be incapable of control."[90] G.Cassel expressed his complete agreement with the "Note of Dissent." According to Cassel, the main culprit attracting gold was France, this helped foster deflation and falling prices and led to protection.[91]

Cassel was not particularly bullish about the prospect of restoring the gold standard, "It is an open question whether it will be possible in the future to restore the gold standard as an international monetary system. It is quite possible that the difficulties will prove insuperable, and that the paper-standard system will attain such stability as to become generally acceptable."[92] The dissenters attributed the collapse of the international monetary system not to structural maladjustments, but to an increasingly maldistributed gold supply particularly from 1929. Large gold flows towards the US and France forced other nations to raise interest rates, which caused deflation and falling commodity prices.[93] Hawtrey held a similar view, "There was a competition among all countries on the gold standard in the

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[89] Report of the Gold Delegation of the Financial Committee, L.N. (1932), p.75.

[90] "Note of Dissent", Report of the Gold Delegation, L.N. (1932), p.69.

[91] *ibid.*, p.74.

[92] Report of the Gold Delegation of the Financial Committee (1932), p.75.

[93] *ibid.*, pp.62-62.

compression of the consumers' income,"[94] viz., competitive deflation. Throughout, the Report expressed concern over the relationship between commodity prices, wages and the debt burden. And the dissenters added that the gold standard was acceptable but only, "if properly managed."[95] Talk of management of the gold standard denoted a radical departure from the *laissez-faire* views expressed in the Cunliffe Committee Report. It is interesting to note how close the views expressed in the "Note of Dissent", and by Cassel, are to those espoused by Eichengreen in his latest *opus*.[96]

Amongst recommendations in the "Draft Annotated Agenda," submitted by the preparatory commission of experts of the League of Nations, in January 1933, we find the argument that, "central banks should be independent of political influence,"[97] and on the future of gold, "We attach great importance to this declaration and to the pursuance of consultations among Central Banks, particularly with a view to achieving the object, as stated in the report of the gold delegation, of checking undue fluctuations in the purchasing power of gold." This had been mooted at Genoa. Quoting Hawtrey on the Genoa conference, of which he was one of the principal architects, central banks ..."should regulate credit with a view to preventing undue fluctuations in the purchasing power of gold."[98]

The Gold Delegation Report marked a step towards Chicago monetarism or managed money, i.e., money would be stabilised against commodities rather than allow prices to fluctuate according to the supply of commodity base money, viz., gold. The report of the Gold Delegation, which pointed to the increase in the real debt burden, called for a readjustment of the price structure which should affect, "not only commodity prices, but also the distribution of income and the rearrangement of production."[99] During the inter-war period Irving Fisher was the great exponent of the maintenance of the internal stability of the currency, viz., a stable purchasing power. His debt deflation theory of the economic cycle

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[94] Hawtrey The Art of Central Banking (1970) p.217.

[95] "Note of Dissent," Report of the Gold Delegation (1932) p.73.

[96] see Golden Fetters.

[97] *ibid.*, p.15.

[98] Hawtrey The Art of Central Banking (1970) p.194.

[99] see, Report of the Gold Delegation (1932) p.47.

(1933) would particularly merit contemporary resurrection as it is perhaps the best available theoretical model for understanding the great world credit bubble of the 1980s and subsequent protracted corporate and personal balance sheet shrinkage of the early 1990s.

Having in the previous section underlined the British viewpoint we shall attempt to give a French perspective on the question of gold maldistribution and the problems with the post-bellum gold standard. As we have tried to underline British economists were increasingly thinking in term of what we would now recognise as Chicago monetarism, whilst French analysts were still very much attached to the Ricardian gold standard model. This will be particularly evident in a letter, which is in fact a statement of policy, submitted by Governor Moret to the Minister of Finance.

It seems that the French came rather belatedly to recognise the perverse effects of deflationary policy. In this respect the British view-point was undoubtedly coloured by the unfortunate experience with post-war deflation, though, as Hawtrey was keen to point out, he had already advocated a unit of account with a stable value as far back as 1919, and this was in part behind the Genoa recommendations aimed at economising gold. One should note too that the tenacity with which states held to gold was part correlated with the degree of post-war monetary instability they had endured.[100]

In his letter Governor Moret expressed the view that the gold exchange standard, favoured by the British, was to blame for the pyramiding of hot footed foreign exchange balances and credit, which allowed a speculative boom to get underway on the back of the artificial reserves created through the accumulation of foreign exchange (claims on reserve centres). Under gold standard conditions this would not have been allowed to develop to such an extent.[101]

Irving Fisher advocated fully backed 100% money so as to constrain the ability of the credit mechanism to create boom conditions, but as Hayek recognised credit booms are an intrinsic part of the capitalist system.[102] And to smother the credit mechanism in order to

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[100] see Eichengreen Golden Fetters.

[101] Quoting Moret, "*Il n'est pas contestable qu'en favorisant un développement abusif du crédit, la pratique de l'étalon de change-or n'ait contribué à aggraver la crise actuelle. C'est la concentration sur certains marchés de stocks de devises, détenues par les Banques Centrales, qui à permis un développement sans précédent d'une spéculation boursière et immobilière dont les effets ont été désastreux pour le monde entier.*" Source: B.F. 4/N 383 B III, letter dated 8 April 1933, to Minister of Finance.

[102] cf., Prices and Production (1934); and Monetary Theory and the Trade Cycle (1st trans., 1933).

contain booms might have more deleterious effects.

Rist in his paper presented before the Chatham House study group pointed out that the argument that the "maldistribution" of gold should be responsible for long term price trends was novel and that historically speaking the relative distribution of gold was little different between 1913 and 1925.[103] Aftalion was to make substantially the same point in his paper submitted to the Gold Delegation. However, as we have argued in chapter two, the pre-war gold standard was characterised by the significant role played by sterling. Some have argued that it was the key role played by sterling and the London money market which was the most significant aspect of the pre-war system. The post-bellum situation had radically altered Britain's relative financial position and the existence of other financial centres, along with an uncertain economic and financial settlement, and speculative capital flows, had totally unsettled the international monetary system.[104] This was compounded by failure to institutionalise co-operation.[105] Furthermore, France did not recycle its surpluses and US foreign lending was highly volatile and produced a false semblance of stability in central Europe.[106]

Nurkse highlighted the more febrile nature of the post-bellum international financial regime in the following extract, "When the comparative prospects of the various centre currencies become subject to discussion, sudden and disruptive shifts of reserve funds will be difficult to avoid. The problem does not arise in a system with only one centre, and an occasional alteration of exchange rates between a member country and that single centre is unlikely to have serious consequences for the functioning of the system as whole."[107] Kindleberger also attributed the instability of the inter-war monetary system to the lack of a single financial hegemon. Eichengreen whilst denying the financial hegemon thesis admits that uncoordinated devaluation did reduce currency reserves as it undermined those currencies

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[103] Quoting Rist, "*Il ne semble donc pas que l'accumulation de l'or en France ait eu jusqu'ici une influence vraiment sensible sur les prix*", in RIIA (1931), p.10.

[104] see Kindleberger (1973).

[105] see Eichengreen Golden Fetters.

[106] *vide.*, Schacht's memoirs.

[107] From abridged article by Nurkse in Eichengreen, The Gold Standard in Theory and History, (1985), pp.219-220.

which had not yet devalued and contributed to beggaring-thy-neighbour.[108] He argues that a general devaluation of currencies would have been preferable, in fact this is what happened albeit in a piecemeal fashion. The major currencies were eventually devalued against gold, thus reflating nominal prices.

In reply to British calls for a redistribution of gold reserves, Rist argued that no sooner had gold been redistributed than it would flow out again as, "the real thing to look at, in my opinion, is not the monetary outflow or inflow of gold, but the organization and the constitution of those different balances of accounts," i.e., that the gold problem was a balance of payments problem.[109] Though, of course, the textbook gold standard model would suggest that a redistribution of gold would automatically cause nominal price levels to rise or fall in proportion to the relative redistribution of reserve base money (viz., gold) and reach an equilibrium steady state level if these reserve flows correctly reflected underlying real current account balance of payments flows (*q.v.*, Ricardo). Strakosch argued that Rist's appeal to Hume/Ricardo automaticity in order to explain gold flows into France was disingenuous. As France had stabilised her currency at a rate below purchasing power parity gold inflows were not "natural"[110] i.e., France enjoyed an undervalued exchange rate. And these inflows were effectively sterilised (i.e., did not expand the domestic note circulation *pro tanto* as postulated by Hume's model) as a result of the very large deposits held by the *Caisse des Dépôts et Consignations* which he estimated at some 14 *milliards* French francs and an increase of Treasury deposits held at the Bank of France of some 5 *milliards* French francs.

One should also mention the practice of the Bank of France of disguising part of its swollen gold reserves during the "gold avalanche" period by holding special accounts at the *Caisse des Dépôts* and private banks. Mouré[111] quotes a figure of FRF 2.5bn. for funds held in these accounts in Spring 1932,- they were also known as "*compte Y.*"[112] However,

[108] Eichengreen (1990) p.11.

[109] RIIA (1931) p.203.

[110] Quarterly Review of Business Conditions (1930) pp.213-214, adopts a similar view.

[111] Mouré (1991) p.76, footnotes 116 & 117.

[112] see Jeanneney (1976).

these "reserves were exhausted during the monetary crisis of May 1935."[113]

Hartley Withers, a prominent financial commentator of the inter-war period, pointed out that the impression often given by the French authorities, viz., that their discount rate was below that prevailing in other centres was somewhat deceptive as the official discount rate which stood at 2% was not an accurate barometer of prevailing interest rates. The rate on advances which was at 4.5%, was a more accurate pointer to borrowing costs. As a result, a superficial glance at the official discount rate gave an inaccurate picture of domestic credit conditions. Withers argued that it was therefore the City view that interest differentials were not as wide as might appear and that as a result of high domestic borrowing costs French banks had imported gold (i.e., run-down foreign balances) in order to acquire francs. In reply Rist argued that the rate on advances was not as important as the discount rate which could be made directly effective through the Bank of France's large branch network.

As to the level of British reserves Rist's view was that if they were augmented the British money market would just on-lend the additional balance. In defence of the French argument, it would seem that to have raised the note issue and built a credit structure on the strength of what might prove to be short term capital inflows could have been both an unstable strategy for France to adopt, particularly given the collective memory of recurrent runs on the currency in the early 1920s,[114] as well as being potentially inflationary. However, Rist recognised that on-lending or re-cycling the surplus would prove useful, though in 1931 the international financial situation was hardly conducive! One should also mention that if the Bank of France had not maintained a cushion, i.e., an additional gold reserve, this could have undermined the exchange rate commitment given the political costs associated with nominal price deflation and/or necessary fiscal adjustment measures.[115] Nevertheless, in the case of France the point was that the Bank of France held a huge surplus gold reserve.

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[113] Mouré (1991) p.76.

[114] see Eichengreen Brookings, October (1985).

[115] see Eichengreen Golden Fetters, p.297, the reference there is to the US, in 1931, but applies no less in a hypothetical French case.

OPEN-MARKET POLICIES:

The British view was that France could either modify the statutes of the Bank of France in order to raise the amount of free gold, although, as we have seen, this was a policy action which Niemeyer cautioned against, or, engage in offsetting open-market policies. From a British point of view this would be simple to effect quoting Hawtrey, "There is no obstacle whatever in the way of the French Parliament and the Bank of France between them allowing the acquisition of French Rentes or the increased accumulation of foreign exchange, and other devices for enabling the note issue of the Bank of France to be maintained at the required level without so much of it being covered by gold."[116] We shall see how at variance with French opinion this entreaty was.

Rist took a demand determined view of credit and argued that, "Even if somebody wished to offer much more credit than is in practice asked for, one would find that the demand for credit is insufficient to balance the credit which could be offered. Hence the very low rates which are characteristics of all crisis periods."[117] The last point is an allusion to the so-called "Gibson paradox", however, it confuses nominal with real interest rates,- one should bear in mind that though average nominal interest rates might seem low in France during the 1930s, real interest rates were very high. However, Rist begs the question, "how about the use of open-market policies? Which aim to inject liquidity into the monetary system, reduce interest rates and increase the supply of money." However, it would be pointed out that large deposits held at the Bank of France belied the contention that there was an insufficiency of credit,[118] and that any resulting funds created through open-market operations could well end-up being redeposited.

Rist rejected the principle of open-market policies on the grounds that the depression had been caused by too much credit over the last five or six years which had over-stimulated production. When consumer demand had proved insufficient the credit bubble burst.[119]

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[116] RIIA (1931) p.159.

[117] RIIA (1931) p.199.

[118] see: Ministry of Finance, B 32 323, "*Note relative aux opérations sur le marché libre et à la politique de la Banque de France*", 25 October 1932.

[119] This is what we now know as the "Austrian" explanation of the trade cycle see v.Mises (1971) and v.Hayek (1934; 1966; 1975).

The depression by implication had a necessary cathartic and purging effect. This was a very Calvinistic interpretation of business cycles. The crash should have come earlier, but for the delay in France's stabilization, as a result France propped-up the bubble by accumulating foreign exchange against sale of francs and further fuelled it by on-lending or re-depositing the foreign exchange in overseas money centres.[120]

Quoting Rist, "As a consequence, this enormous buying of francs, instead of bringing, as it ought to have done, an inflow of gold into France, maintained the same monetary redundancy on foreign markets. The result was an enormous creation of francs in France itself, which made it possible for the French Government to repay to the Bank of France the advances it had received during the War. That is one point. But there is another. When the Bank of France began to buy gold itself in those markets in which it had big deposits, especially in the United States, what did the Federal Reserve Bank do? The Federal Reserve Bank bought on the market an amount of government security exactly equivalent to the amount of gold which was earmarked by the Bank of France. It created on the market exactly the same quantity of dollars which were taken out in the shape of gold by the Bank of France. I do not want to criticize that policy - I admit that it was justifiable at that time - but what was the result? It prevented the natural outflow of gold out of a country which was buying at high speed all kinds of shares, bonds, and goods in France. These two policies had the same result: by increasing the amount of credits on the world markets, they prevented the disequilibrium already existing between consumption and production from being felt as soon as it ought to have been."[121]

And according to Rist such policies would prove as damaging in a French context, "To-day, some people are advising other countries, for instance France, to create more

[120] RIIA (1931) p.201-202.

[121] Rist, RIIA (1931), p.202. It is interesting to note the extent to which Rist's explanation of the causes of the depression are consonant with the Austrian business cycle theory, particularly the work of v.Mises (1971). Mises postulates a theory of the cycle which is driven by a lowering of the rate of interest below its "originary rate," i.e., that which expresses the equilibrium between present and future consumption. This interest rate representing the inter-temporal consumption ratio would in turn dictate the level of investment, viz., the allocation of goods through time. Equilibrium is achieved when the level of inter-temporal production equals that of consumption. However, if the authorities artificially lower the "originary rate" production would be stepped up and lead to eventual over-production relative to future demand. The downturn comes when the level of forced savings required to finance production fail to materialise as savers require a higher rate of interest to compensate for increased prices, and consumption demand fails to meet the optimistic forecasts which had been artificially driven by the depressed rate of interest due to a loose credit policy. The policy prescription to restore equilibrium is to tighten credit and allow a return to equilibrium.

credits - in other words, to use these same means which in my opinion have contributed to intensify the present crisis. I cannot but feel that those who advocate such methods, and still more those who would adopt them, assume a very big responsibility. Such methods do not seem to me at all able to improve the maladjustment between prices, consumption and production. I feel on the contrary, that they have very largely contributed to prevent an adjustment which could have taken place earlier."[122] This refusal to countenance any interference with the market was quite characteristic of French thinking, at this time at least.

Rejection of a policy considered tantamount to covert inflation, "*inflation déguisée*", was again made in a memorandum from the Bank of France to the Ministry of Finance.[123] It argued that open-market policies had only ever been resorted to to create an artificial inflation of credit and thereby disguised inflation. This paper went-on to argue that the effect of such a policy would be only to increase the central bank's *seigniorage* as it would be issuing non-interest bearing liabilities, viz., bank notes, and acquiring as a counter-part interest bearing assets, viz., Treasury bills.[124] This note demonstrates a certain degree of suspicion *vis-à-vis* the Bank which seemed largely unwarranted. Though the Bank remained nominally private it had since 1803 been very much under the control of Government, which appointed its Governors and past practice suggested that some sort of accommodation could have been reached whereby the Bank surrendered the interest earned on bills against a nominal transactions fee. The statement is significant though in indicating the extent to which the Bank, in some quarters, was considered a private institution, rather than a national central bank.

Mouré points out that the Bank of France faced a conflict of interest in 1935 when Governor Moret was pressed by the then Finance Minister, Germain-Martin, to reduce interest rates as the Bank was concerned at the loss of income which would result.[125] In

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[122] RIIA (1931) p.202.

[123] M.F., B 32 323, 25 October 1932, referring to open-market policies, "*...elle n'a jamais été mise en pratique qu'en vue d'augmenter artificiellement le montant du crédit en circulation, et de provoquer ainsi une inflation déguisée.*"(p.1).

[124] "*L'achat de valeurs d'Etat par la Banque de France aboutirait, d'ailleurs, à une inflation déguisée au détriment de la monnaie nationale et au profit de l'Institut d'Emission qui abuserait ainsi de son privilège d'émission pour se rendre acquéreur de titres dont le revenu accroîtrait ses bénéfices.*" *ibid.*, (p.6).

[125] Mouré (1991) p.171.

fact Mouré constantly alludes to the Bank's concern in this regard. This tends to support the suspicious regard in which the Bank was held by the left and amongst some centrist politicians, e.g., Germain-Martin.

There were also technical reasons adduced for rejecting open-market policies in France. We shall examine these in part by means of an analysis of a letter from Bank of France Governor C.Moret to the French Finance Minister - judging from its contents this letter, or, perhaps more accurately memorandum, was probably prepared for the Finance Ministry in order to clearly define official policy at a time when France was in the midst of depression and ahead of the London World Economic Conference - its contents bear remarkable similarity to the, *"Note relative aux opérations sur le marché libre et à la politique de la Banque de France"* (op. cit.).

Moret denied that the Bank of France had sterilized gold, pointing out that from June 1928 to March 1933 29 *milliards* francs of gold had flowed in and sight liabilities had increased by 34 *milliards* francs and, yet, wholesale prices had fallen from 617 in December 1927 to 390 in December 1932. Though this was to say the least disingenuous, as the French wholesale index was mainly composed of commodities whose prices had weakened world-wide. Additionally in an environment characterised by falling prices and uncertainty the cost of holding real balances falls (the velocity of circulation drops),- which explains in part the very substantial holdings of currency in France. Alluding to the Fed's open-market policies Moret pointed out that they failed to halt the decline in prices and that it was not just a question of the supply of credit, but also of the demand. Moret underlined the fact that rates were lower in Paris than in London and New York. The note prepared by the *Banque de France* for the Ministry of Finance argued that interest rates in London were not high enough during the period 1929-32 to compensate for the currency risk, and therefore private banks and economic agents holding balances abroad, particularly in London, had repatriated them as the rate of return did not appear to compensate them for the potential risk.[126] Hawtrey argued that this reflux of capital was prompted by a desire for greater cash balances, and given the statutes of the Bank of France these could only be reconstituted

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[126] *"Si, de 1929 à 1932, les Banques privées et les commerçants qui avaient des créances extérieures lui ont vendu de l'or en liquidant leurs avoirs étrangers, notamment à Londres, c'est parceque les taux pratiqués sur le marché anglais n'étaient pas suffisamment élevés pour justifier le risque que présentait la détention d'un portefeuille en sterling."* M.F., B 32 323, pp.6-7.

through the sale of gold to the Bank of France.

Moret also refused to endorse the idea of a stable price level, which as have we have seen was now becoming a prime objective of British policy-makers. Moret argued along "Austrian" lines that prices are signals, stimuli, and as such should not be tampered with. A central bank should not have as its objective price stability, but currency stability. On the issue of loan financed public works suggested by Keynes, Moret rejected them on the same grounds as they were apparently rejected in the preparatory paper by the Geneva experts, viz., that it would reduce the state's credit, hinder debt conversion operations and so retard the process of lowering the long term rate of interest.[127] In the UK Hopkins, of the Treasury, shared this view. Moret, however, did reject introducing internal gold circulation as it could lead to greater hoarding and further accusations of gold sterilisation.

Moret then went-on to reject open-market operations. Moret pointed-out that the statutes of the Bank of France precluded open-market operations,- though he did not mention that it could purchase bills on account of foreign central banks and was entitled to market Treasury bills, which had been credited to its account to compensate it for losses on Russian loans and sterling balances.[128] These funds were not insubstantial. The Bank of France had received 5,930 million francs worth of Treasury bills in compensation for defaulted Russian war loans. These bills were surrendered for bills drawn on the *Caisse d'Amortissement*, effectively removing the liability from the government balance-sheet.[129] The Bank of France also received 2,342 million francs worth of bills in compensation for losses incurred on sterling balances,- the same indirect compensation process was used.[130] None of these bills were marketed though, principally it seems, because they were zero-coupon bills and as such would have sold at a discount to face-value resulting in a loss for the Bank. They were also subject to an 18% tax schedule and 2% turnover tax, both of which would have been factored into the price, resulting in further losses, though, presumably, the Treasury could have extended an exemption to these bills. Eichengreen (Golden Fetters) suggests, quoting Netter, that the reason these were not issued was because

[127] For similar "crowding-out" arguments adduced by French policy-makers see chapter seven of this thesis.

[128] cf., Mouré (1991); and chapter two and documentary Appendix to this thesis.

[129] see Servais (1938).

[130] see Sandoz (1936).

of opposition from regents within the Bank council who opposed managed money.

By far the most interesting aspect of Moret's opposition stemmed from the argument based on the radically different credit and monetary structure prevailing in France compared to the UK.[131]

Moret argued that given the nature of the French credit market open-market operations would not have any effect on the volume of credit, or prices. Moret pointed out that the Gold Delegation had come to the same conclusion. However, as we have seen this was not the view of the dissentient voices on the Gold Delegation. And there was no lack of public debt (*rentes*) held in private sector portfolios. Moret argued that the wide dissemination of *rentes* in private portfolios, rather than held by financial institutions, meant that they were effectively withdrawn from the financial circuit and therefore precluded the sort of operations conducted by the British authorities.

It is certainly true that France did not have the sort of sophisticated money market structure which characterised the City. Mouré argued that one of the reasons for Moreau's resignation from the governorship of the Bank of France had been his inability to develop a sophisticated discount market.[132] Mouré argues that this was an ambition shared with P.Quesnay, the Director of Studies at the Bank.[133] Such a policy would certainly have required the wider use of discounts of government paper by the central bank in order to make its control over the money market effective. This is rather paradoxical as Moreau would certainly have found open-market policies anathema and a departure from sound banking principles.[134]

Moret argued that the Bank of France could not resort to open-market operations in any case, as it did not have a substantial portfolio of government debt - though in this case

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[131] Quoting much of Moret's statement in *extenso*, "*Ainsi que vous le savez, les statuts de la Banque de France lui interdisent d'entreprendre ces opérations. Elles ne présenteraient, d'ailleurs, en France, aucune utilité. La Délégation de l'Or à Genève, qui a étudié cette question de manière approfondie, a reconnu qu'..." étant donné la structure particulière du marché français, elles n'exerceraient aucun effet appréciable sur le volume du crédit et le niveau des prix.*" Moret's arguments are similar to those propounded by Professor Aftalion in a paper submitted to the L.N. Gold Delegation, see, M.F. file B 32 316.

[132] Mouré (1991) p.135.

[133] Mouré (1991) p.136.

[134] see his memoirs in which he constantly warns of the need for vigilance to avoid discounting "*papier de cavalerie*" or kite flying, that is discounting phoney commercial bills. The equivalent of discounting post-dated cheques.

it was a question of purchasing government paper to expand the money supply and not the other way round, and, as we have seen, the Bank of France did hold a substantial portfolio of bills which it was entitled to place with the market. Eichengreen (Golden Fetters) has argued that in any case it might well have proved counter-productive.[135] However, the main technical point adduced against the effectiveness of open-market operations in France was the far greater use of notes as opposed to credit, viz., cheques, used in the UK and US, and the lack of a sophisticated money market as in the UK. This meant that open-market operations could not have the same effect in France.[136] Moret even suggested that open-market policies could undermine confidence in consols (*rentes*), given the French rentiers' post-war experience this is not to be dismissed lightly, though again the question was rather of the purchase of government paper and not its sale. Nevertheless, given the prevailing financial orthodoxy such purchases might be construed as equivalent to a share support operation by the government to increase its credit rating.

Mouré (1991) argues that the experience with discretionary monetary policy before stabilisation under the system of "*règles de plafonds*" explains the reluctance of the Bank to endorse anything which smacked of managed money (*monnaie dirigée*). And he cogently argues that had the Bank of France engaged in open-market operations the public would have reacted negatively recalling past experiences, particularly the "*avances occultes.*" Mouré adds that in the circumstances balanced budgets, or at least the semblance of achieving such a target, was essential to maintain confidence.[137]

Moret argued that open-market policies would not have the same effects in France as French banks maintained larger reserves than English banks because of the need for greater liquidity to face withdrawals in a less sophisticated market environment, therefore credit conditions were not determined so much by the level of reserves. Moret argued that the Bank of France could act directly on the credit market, without the need to make its rate effective by recourse to open-market policies, simply by making changes in the Bank of

[135] see also chapter two of this thesis.

[136] Quoting Moret, "*...une des caractéristiques essentielles de la dette publique française étant sa dissemination dans le public. Les valeurs d'Etat sont classées dans une multitude de portefeuillles privés et sont pratiquement retirées du marché de l'argent. Y aurait-il lieu, en vue d'une action monétaire dont le principe même est contestable, de provoquer un déclenchement de la rente, éminemment dangereux pour le crédit public?*"

[137] Mouré (1991) p.155.

France's discount rate. The Bank of France with some 260 branches widely dispersed throughout the country could ensure that the Bank would be in constant touch with the market. Moret concluded that open-market operations did not conform either to the economic, or credit structure of France.[138]

However, Moret failed to mention that one reason commercial banks held large reserves was to avoid having to rediscount paper with a commercial rival, viz., the Bank of France, and so risk losing future business.[139] This implied that the central bank was not as easily able to influence the market as Moret suggested, furthermore commercial banks also tended to run-down foreign assets in case of stringency rather than go to the Bank of France.[140] The resultant would be an inflow of gold into France. Crump pointed out that during the banking crisis of November 1930[141] banks ran down their foreign balances to meet their commitments - this would of course swell the gold reserves of the Bank of France under the existing legislation, as the Bank of France could not hold foreign exchange as reserves (excepting existing balances).

The deficiencies of the French credit and money market are well illustrated by the following passage taken from an article in the Quarterly Review of Business Conditions entitled, "The French demand for Gold" (July, 1930).[142]

"But the arrangements of the Paris money market are old-fashioned to a degree that is astonishing, when we compare it with the keen intelligence and highly developed civilisation of our French neighbours in other respects. In practical fact, anyone who wants currency or credit from the Bank of France, gets it by handing over gold. There is no central pool of short money, lent by the commercial banks to a ring of discount houses, as in London, which money the banks can call in from the discount houses, which in turn

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[138] Quoting Moret, "*Les opérations sur le marché libre ne correspondent ainsi, en France, ni à la structure économique du pays, ni à l'organisation de crédit.*" One should note that Moret adhered to a demand determined theory of credit and money, viz., the banking school view as opposed to the Hawtrey's analysis which stressed the importance of maintaining the supply. The latter effectively prescribes "intervention," e.g., open-market policies to maintain or raise the supply of money.

[139] see Mouré (1991).

[140] see Mouré (1991).

[141] see Bouvier.

[142] In Ministry of Finance, file, B 32 316.

replenish their supplies by borrowing from the Bank of England or discounting bills with it. There is no custom, as in the United States, whereby the member banks of the Federal Reserve System can and do rediscount bills at the Federal Reserve bank and so widen the basis of credit. On the contrary, the last thing that a French commercial bank wants to do is to take bills to the Bank of France, and for a reason that is interesting. Nowadays, central banks that have been established in the light of recent experience are enjoined to confine themselves to acting as bankers to the Government and to the other banks, and do not, or should not, compete with the latter for ordinary banking business. But the Bank of France discounts commercial bills at its 257 branches and auxiliary offices all over the country to a considerable extent - on July 3 it held £45 millions' worth - and the commercial banks fear that by taking bills to it for rediscount, they will be giving away their own business. If they do ask for advances, it charges them 4.5% (2% above the official rate);[143] so when they need more currency, the simplest course for them is to draw on their balances abroad and bring gold home and deliver it to the Bank of France. And the Bank of France is helpless. There is no discount market; moreover, incredible as it may seem, it is forbidden by law to hold investments or to effect open market operations for its own account, and the Bank of France is therefore unable to employ a "hidden hand" to buy Treasury and other bills and so swell credit."

It was argued by some French policy-makers that it was precisely because of this fundamental difference in market structure that the French authorities did not need to have recourse to open-market policies in order to make a change in credit policy effective. In the UK such a large superstructure of credit existed that not only would an outflow of gold have to act on the note circulation, but also on the level of credit extended by commercial banks. In order to do this it was thought that the Bank of England had to have recourse to open-market operations to mop up liquidity thereby forcing the discount houses to the Bank of England's (re)-discount window to make the rate change effective. This view is explicitly stated in a memorandum prepared by the Ministry of Finance on open-market policy.[144]

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[143] Which is what H.Withers had argued (*vide supra*).

[144] "*Dès lors, pour qu'une sortie d'or exerce une action sur le niveau des prix, il est indispensable, non seulement qu'elle provoque une diminution de la circulation de la Banque d'Angleterre, mais aussi et, surtout, qu'elle détermine une contraction du volume du crédit privé. La Banque d'Angleterre ne peut atteindre ce dernier résultat que si, par des ventes de titres, elle crée un resserrement suffisamment marqué pour obliger les banques privées à restreindre leurs prêts.*" M.F., B 32 323, "*Note sur l'Open Market Policy,*" reproduced

Conversely in France the level of credit outstanding - measured here by the level of deposits in the four largest credit institutions - was far lower relative to the outstanding stock of notes. The paper gave the following figures: 85bn. for the note circulation, whilst deposits at the four largest credit institutions only amounted to 35bn. francs. It was therefore argued that the outstanding stock of monetary instruments, and one assumes quasi-money, were far more closely under the control of the Bank of France which with its widespread network of branches and discounts would be better able to control the supply of notes in circulation through its discounts of "real" bills.[145] It is interesting to note that this sort of argument could have been propounded in England circa 1810 by the banking school. Nevertheless, Mouré using Netter as a source points out that direct discounting by the Bank of France was less than 10% of discounts by major commercial banks and that the Bank could hardly claim to lead the market.[146] However, it would seem that its role would be enough to give direction to the market, particularly if the Bank was considered a competitor to the commercial banks. Nevertheless, without open-market policies the authorities would clearly lack clout, particularly to tighten money market conditions.

With respect to the UK it is not necessarily the case that the Bank had to have recourse to open-market policies to make a change of bank rate effective. This would depend on conditions in the money market, and the use of open-market operations merely added to the efficiency of bank rate by allowing the bank to remain in constant touch with the market and making any rate change more immediately effective. Furthermore, in a system in which funds were constantly on-lent and placed for example in the overnight market with the discount houses, which used these balances to finance their discount business,- so building what the French would term an inflated credit structure,- one would expect any tightening or loosening of official credit policy to be more immediately felt. In the French case as we have seen the Bank of France was in direct competition with commercial banks and this,

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in documentary Appendix.

[145] Quoting the original document, *"En France, la situation est différente. Le principal instrument de paiement est le billet de banque et non le chèque. La circulation de billets s'élève, en effet à 85 milliards alors que le montant des dépôts dans les quatres grandes sociétés de crédit ne s'élève qu'à 35 milliards de francs.*

"Il en résulte qu'en France le volume de la circulation monétaire est placé, en majeure partie, sous le contrôle de la Banque de France et toute sortie d'or entraîne une contraction monétaire suffisante pour agir sur le niveau des prix."

[146] Mouré (1991) pp.129-130.

along with the inefficiency of the market (illiquidity), meant that commercial banks held far higher reserves. Thus making, in theory, a rate change slower to alter market conditions; particularly, when the commercial banks held large balances off-shore. When these balances were repatriated in the form of gold the Bank of France would be obliged to deliver francs against them (once the sale of foreign exchange had raised these currencies on the exchanges and the franc had reached its gold import point).

Today, we would prescribe flexible reserve requirements for a market structure such as France's in the inter-war years, akin to that operated by the US Federal Reserve. By raising mandatory reserve rates the Bank of France could have sterilised some of the commercial banking sector's free reserves and this could have been extended to off-shore balances. This would have forced commercial banks to rediscount at the Bank of France. However, this does not answer the difficulty in the French system in which the central bank was essentially playing a passive role with market conditions determined by the demand for credit. Mandatory reserves would be more likely to work, as in the example cited above, if the central bank wanted to tighten policy, though if commercial banks were acting as profit maximisers a relaxation of mandatory reserve ratios would induce them into being more aggressive in their discount policies and loans. Nonetheless, an open-market policy would have opened-up the possibility of managing the supply of credit.

The deficiencies of a system in which the central bank plays a relatively passive role were gradually realised and when Governor Fournier came out in support of open-market policies, these deficiencies were specifically highlighted by him at a meeting of the *Conseil Général* of the Bank of France. His preoccupation was that the Bank of France's rates were below those in the market and that the Bank had no direct means of making them effective and that the adoption of an open-market policy would allow him to make the looser credit conditions effective. Fournier's main preoccupation was the possible effect on the foreign exchanges.[147]

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[147] Quoting Governor Fournier, "*Actuellement, le marché est exsangue; il serait logique de lui fournir des fonds. Ce qui fait hésiter M. le Gouverneur, c'est seulement la crainte des répercussions qu'un élargissement monétaire pourrait avoir sur le change. Mais il n'est pas douteux qu'en soi l'extrême rareté actuelle des disponibilités comporterait le jeu d'une politique d'Open Market. L'état du marché est complètement anormal; c'est ainsi que les taux qui y sont pratiqués sont supérieurs au taux de la Banque. M. le GOUVERNEUR s'est préoccupé de remédier, dans une certaine mesure, à ces anomalies en utilisant les services de certaines maisons spécialisées, qu'il a chargées d'intervenir pour essayer de niveler les taux.*" From B.F. "*documents fournis au Gouverneur pour la séance du Conseil Général du 25 Mai 1972.*"

It is also interesting to note that the Bank felt that extending the activities of the Bank, i.e., discounting more aggressively in order to have greater influence on the market, should be rejected as it could undermine existing collaboration with commercial banks and the benefits to be derived from such a policy would be minimal.[148]

This confirms our earlier assertion that the commercial activities of the Bank of France could hamper, rather than assist, the Bank's control over the money and credit market. This is contrary to what was averred in the, "*Note sur l'Open Market Policy*" (*vide supra*); particularly, in a market environment in which the Bank often relied on "moral suasion" to make its policy effective and did not want to compromise its relations with the commercial banks.[149] We saw in chapter nine, on the domestic conduct of policy during the Gold Bloc period, that the Bank often acted in this way. In the UK "moral suasion" was based on the central authority of the Bank of England.

The minutes of the Bank of France go-on to state that the Governor was studying the impact of open-market operations, at the behest of the Government. The Governor viewed such a policy development favourably, though the Bank should be firmly in charge of such policy. Open-market policies were formally approved under the decree-law of 17 June 1938, documents (*vide supra*) at the Bank of France indicate that Fournier inspired (*inspira*) and implemented open-market policy. Though the war intervened this marked a radical departure for the Bank of France and Government whose tool it had now become (though to a certain extent it had always been) and meant that the political authorities had begun to accept a far wider responsibility for monetary and, by implication, macro-economic management.

Whatever the merits of implementing open-market policies, given the contemporary French money and credit market structure, it is not quite true that the authorities were precluded from engaging in such operations. In fact the Bank was empowered to sell and

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[148] Quoting the minutes of the "*Séance du Conseil Général,*" 23rd June 1938, "*Il reste enfin à envisager la possibilité de développer l'activité de la Banque. Mais, là encore, nous sommes assez bridés. Que l'on essaye d'étendre cette activité dans un sens qui profite à l'ensemble du marché, rien de plus souhaitable, mais M. le GOUVERNEUR n'entend pas faire concurrence aux établissements bancaires; cela ne pourrait que les écarter de nous, compromettre une collaboration qui est des plus nécessaires. D'ailleurs, les bénéfices que nous pourrions attendre d'une pareille concurrence ne sauraient être que minimes. Au total, les inconvénients l'emporteraient sur les avantages.*" Source: B.F., "*documents fournis au Gouverneur pour la séance du Conseil Général du 25 Mai 1972*", extracted from: *Conseil Général, séance du 3 Mars 1938.*

[149] The recourse to "moral suasion" is evident in the Governor's statement quoted above (*séance du Conseil Général, 3 Mars 1938*).

buy zero coupon three month Treasury bills which were held by the Bank as a counter-part for Treasury bills which were transferred from the Bank of France to the *Caisse d'Amortissement*. The original Treasury bills had been issued to the Bank of France in order to compensate it for losses on defaulted sovereign loans, principally Imperial Russian bonds, and for losses incurred by the Bank of France on its foreign exchange holdings, namely on its sterling balances. The Bank was fully empowered to sell and buy the Treasury bills delivered to it as a counter-part. This facility was never used. The sums were not inconsiderable, though diminishing through time as the "*Caisse*" amortised the underlying bills. The figures given are the following: 6.9 *milliards* francs on 31 December 1931, and 6.8 *milliards* francs on 31 December 1932.[150] Lower figures are sometimes quoted, but they appear to exclude bills received in compensation for losses incurred on defaulted Russian loans. Eichengreen points out that the value of bonds issued in compensation for losses incurred on Russian Imperial loans, some FRF 6bn., only amounted to 5% of M1.[151] Nevertheless if sold to the banking system, thus depleting its reserves, it would not be without having effect as it would have multiplier effects on the credit structure.

Furthermore, though the Bank was perhaps limited in the extent of its ability to act directly on the market this was by no means the case for the *Caisse des Dépôts et Consignations* which was the repository for deposits made with the *Caisse d'Epargne*

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[150] source, M.F., B 32 323, "*Moyen d'Action sur le Marché Monétaire Donné à la Banque de France par la Convention du 23 Juin 1928*," dated 22/9/33. The full text is quoted here in *extenso*.

"En exécution de conventions passées le 23 Juin 1928 et le 7 Décembre 1931, la Caisse d'Amortissement a pris en charge l'amortissement des Bons du Trésor jusqu'alors détenus par la Banque de France, d'une part en représentation d'avances de l'Etat à des Gouvernements étrangers (bons russes), d'autres part en compensation de la perte subie par la Banque, du fait de la dépréciation de certaines devises étrangères.

"En échange de ces bons du Trésor, il a été remis à la Banque de France des bons de caisse sans intérêt à 3 mois d'échéance.

"Aux termes des conventions intervenues, la Banque de France aura la faculté de négocier sur le marché les bons de caisse, si elle le juge utile, pour agir sur le volume du crédit et garder le contrôle de sa circulation; elle pourra également racheter avant leurs échéances les bons ainsi négociés.

"La vente des bons de caisse aurait ainsi pour effet de provoquer un certain resserrement sur le marché des capitaux. A l'inverse, en rachetant ces bons, la Banque pourrait augmenter l'aisance du marché monétaire.

"En fait, la Banque n'a jamais usé de la faculté qui lui a ainsi été donnée. Au surplus, il convient de noter que l'importance de ce moyen d'action diminue chaque année, car, au fur et à mesure que la Caisse Autonome amortit les bons dont elle a reçu la charge, la Banque de France remet à la Caisse un montant égal de bons de caisse. C'est ainsi que le montant de ces bons qui s'élevait au 31 Décembre 1931 à 6.898.658.000 F., n'était plus au 31 Décembre 1932 que de 6.802.407.000 F., dont 4.652.435.000 F. représentant les bons de caisse émis en vertu des conventions du 23 juin 1928 et 2.149.972.000 F. pour l'application des conventions du 7 décembre 1931."

[151] Golden Fetters, p.197.

(savings banks) and for funds held in escrow, and on behalf of minors. The funds controlled by the *Caisse des Dépôts* were very substantial. The *Caisse des Dépôts* was also responsible for the *Caisse d'Amortissement* which was created by the Law of 7 June 1926 and guaranteed Constitutional Autonomy under the amendment of 10 August 1926.[152] The *Caisse d'Amortissement* enjoyed revenue from ear-marked funds, e.g., the tobacco monopoly, to consolidate the floating debt. These funds could amount to some 21 *milliards* francs.[153] It is evident from the press files at the Bank of France relating to the appointment of Tannery as Governor (1935-36) - he had been head of the *Caisses* - in succession to Governor Moret (1930-35), that the *Caisse des Dépôts* was considered to have the ability to engage in what were in practice open-market operations.[154] In fact it was used as a vehicle to prop up the market for Government debt. The issue arose because it was felt that Tannery with his wide experience investing in Government stock,- obtained from his experience as head of the *Caisse d'Amortissement* since his appointment by Poincaré,- would be more pliant to Government requests for assistance, e.g., by agreeing to discount a wider range of paper. Tannery was appointed Governor by Flandin whose economic policy was characterised by a rejection of deflation,[155] for which he needed to secure wider discount facilities at the Bank of France for government paper.

One should note that the Flandin/Germain-Martin policy aimed at borrowing short, hence the need to secure the Bank's approval to rediscount Treasury bills. It was thought that this would ease pressure on the long bond rate, i.e., inverting the yield curve, which would assist investment and reduce government debt/service costs. This reliance on short-term funding became perverse as the political and economic crisis deepened and the government found itself unable to raise loans and had increasingly to rely on expedients such as "*avances indirectes.*" This eroded credibility and forced a rise in the discount rate. In

[152] see article by Watteau, who was a sometime Director of the *Caisse des Dépôts*. For a history of the *Caisse d'Amortissement* see Priouret (1966).

[153] source: B.F., press files.

[154] see Mouré (1991) p.145, footnote 91.

[155] His predecessor, Moret, had managed to antagonise Germain-Martin (see his memoirs of office) and Caillaux! Moret had at times refused to ease the Treasury position; support the Wheat loan board; bail out Citroën and widen the discount and rediscount facilities available at the Bank of France discount window. For articles on Tannery's appointment and the *Caisse des Dépôts et Consignations* see B.F., file 7/E 69, *Politique Monétaire* 6, 1935, *(premier trimestre)*.

fact the policy had the opposite effect to that desired.

In 1937 the *Caisse* held 37.3% of its assets in French *rentes* or 39.5bn. francs, the rest was invested in para-statals. In 1938 the proportion of its assets invested directly in government debt rose to 44.3%.[156]

It is obvious that with that sort of financial clout the Government, through the mediation of the *Caisse des Dépôts et Consignations* - if not the *Caisse d'Amortissement* which was established by Constitutional amendment with the clear remit of redeeming and consolidating short-dated Government paper - could have adopted a more vigorous "open-market policy" by, for example, reducing its liquid balances at the Bank of France. However, an important *caveat* is in order, and that is that public confidence should not be undermined, and Mouré points out that in the early 1930s relations between the "*Caisses*" and the Bank were bad.[157] Presumably this altered when Tannery, former head of both "*Caisse*" was appointed Governor of the Bank of France in January 1935. The "*Caisse*" maintained high liquidity ratios in case of a run on savings banks. This concern with confidence is also evident in Governor Fournier's contingent acceptance of open-market policy, i.e., that it should not contribute to undermining the exchanges. The French authorities were understandably obsessed with the need to avoid a recurrence of the continuous foreign exchange crises of the early 1920s.[158] Given the prevailing conservative orthodoxy, government purchase of "gilt-edged" stock, whether direct or through, e.g., the "*Caisse*," could well have been considered the prelude to inflation and have undermined the market for Government debt.[159]

With respect to proposals that the Bank of France should have engaged in open-market operations to stimulate demand during the depression of the 1930s it is undoubtedly the case that this would have been more than counter-productive, given French monetary experience before the Poincaré stabilisation and prevailing orthodoxy. Any injection of cash into the monetary system would have excited inflationary fears, the newly created balances

[156] see Laufenberger (1940).

[157] Mouré (1991) p.145.

[158] see Eichengreen's Brookings Paper, October (1985), - and the importance of assessing policy choices from within the historical, political and economic nexus from within which they emanate.

[159] see Governor Moret's memorandum to the Ministry of Finance.

would have been surrendered for gold exerting pressure on the foreign exchanges, and the decline in official reserves would only have exacerbated the process,- Eichengreen[160] and Mouré (1991) share this opinion.

Watteau's Lecture (1946) on the "*Caisse*" made the point that the *Caisse Autonome d'Amortissement* had, since 1929, seen its ability to amortise Government debt widened and with the "*Loi des Finances*" of 31 March 1931, had been empowered to amortise all Government debt.[161] Watteau went-on to suggest that in fact the *Caisse d'Amortissement* had operated a voluntary, i.e., beyond its strict legal remit, policy of government debt amortisation.[162] This suggests that the "*Caisse*" had the *de facto* ability to engage in open-market operations. The purchase of Government paper which this implied is tantamount to open-market operations, though, of course, the effect of open-market operations lies in their being co-ordinated with the monetary authorities.

Certainly with the creation of the *Fonds de Soutiens des Rentes*, in 1937, it cannot be imagined that this faculty did not exist in practice,[163] though by then it was no longer an international issue revolving round the question of the level of world liquidity, as it had been during the "gold avalanche" years (1928-32), as France was losing large quantities of gold and most countries had either abandoned gold and/or devalued. But, at least, it added to the Government's policy armoury, though only as a further instrument to bolster a chronic fiscal imbalance and as such it could be said that the more conservative opponents of open-market policy, who had argued all along that it was tantamount to inflation, "*inflation déguisée*," were in the end vindicated, as the *Fonds de Soutien des Rentes* and subsequent open-market facilities would only provide short-term alleviation and so defer necessary fiscal adjustment. In a sense this rather points to a certain difference in approach in the debate

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[160] Golden Fetters, p.298.

[161] Watteau (1946) p.23.

[162] Quoting Watteau (1946), "*Par ailleurs, la Caisse a poursuivi une politique d'amortissement facultatif par voie de rachat en bourse, jusqu'à ce que la création du fonds de soutiens des rentes* (July 1937) *l'ait amené sur ce point à suspendre ses opérations.*" (p.24).

[163] Laufenberger (1940) argued that this was not the case as the *Fonds de Soutien Rentes* acted at the long-end of the yield curve, buying and selling gilts, whilst he associated open-market policies with the short-end, i.e., operations which would affect conditions in the money market. He argued that one had an incidence on the stock market and the other on the money market. The *Fonds de Soutien des Rentes* fell under the control of the *Caisse d'Amortissement*, and the *Fonds de Stabilisation des Changes* under the authority of the Governor of the Bank of France.

over open-market policies, namely that British economists and policy-makers,- who were highly critical of France's policies,- saw the problem predominantly from an international perspective (bar Hawtrey who linked it directly with the need on the part of French economic agents to reconstitute a certain level of real cash balances), whilst French policy-makers were more concerned with its domestic impact still keeping well in mind the experience of the early 1920s.

This is a view shared by Eichengreen who, in judging the maldistribution of gold debate conducted under the auspices of Chatham House, argued that, "Not surprisingly, the discussions of the Royal Institute's study group in 1931 suggest that the assumptions of British participants about options open to French authorities were heavily based on British rather than French experience."[164] Despite this difference in emphasis there is no doubt that there was a fundamental disagreement with French economists and policy-makers arguing on what we would now call "Austrian" lines that open-market policies were, very much, a syndrome of what had gone wrong in the post-war financial world with an artificial pyramid of credit built-up during the 1920s which had forestalled the necessary re-adjustment of production to post-war conditions. Therefore, open-market policies would, but contribute to this artificial financial climate and any further departure from financial orthodoxy could only undermine government paper. This is a further incidence of the extent to which co-operation was impaired by different conceptual frameworks and historical experience.[165]

UK economists and policy-makers chastened by the earlier disastrous return to pre-war gold par had come to accept the need for a currency with a stable internal purchasing power and were quite willing to intervene, if need be, to ensure that this obtained. The cumulative perversity of deflationary policies in a relatively fix wage-price world, given the nature of the shock, was increasingly apparent to anglo-saxon economists, as well as the effect of falling prices on real debt burdens. This was also recognised in the League of Nations Gold Delegation Report, "One of the major defects in the economic organisation to-day is that debt has so largely taken the place of ownership."[166]

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[164] Eichengreen (1990) p.101.

[165] see Eichengreen Golden Fetters.

[166] Report of the Gold Delegation of the Financial Committee (1932) p.18. Increased leverage also characterises the present (1992) debt deflation, as private and corporate sector balance sheets are corrected through shrinkage. The erstwhile recourse to inflation to rapidly reduce real debt burdens being no longer

However, what is hopefully apparent from the preceding discussion is that the question of open-market policies was not as clear-cut as is often supposed when commentators look back with the benefit of hindsight. Given the habit of maintaining very substantial hoards of notes in France, sometimes put at some 20 *milliards* francs, it may have been that any additional cash created through open-market operations would have been added to these balances, increasing the potential internal and external drain in case of crisis, or led to a flight into real values (inflation) which some feared would follow devaluation. Though, if open-market policies had been used at a time of gold inflows this could have supplied banks and private economic agents with the additional demand for cash balances (*q.v.*, Hawtrey). Though to base one's whole credit structure on increasingly volatile short-term capital flows can be a high-risk strategy. In order to complement open-market operations variable reserve ratios, which nobody seems to have considered, would have been certainly useful as a means of tightening policy and even in helping to loosen policy (e.g., during the November 1930 banking crisis), though in deflationary circumstances such a policy is limited by the lack of credit demand, which open-market operations are designed to overcome. It is not obvious that in such a depressed economic environment, in an economy characterised by the widespread use of notes, relaxation of reserve requirements would reduce gold inflows aimed at securing additional notes. This is particularly the case if the notes were desired for hoarding purposes and if the central bank adhered to banking school principles.

This is where a distinction between currency and credit is important.[167] For if credit demand is down, because of a downswing in the trade cycle, economic agents will not hold sufficient bills for discount to satisfy the demand for cash,- "real" bills being the product of commercial relations and its attendant by-product, viz., credit and ultimately cash, are both the result of confidence, "animal spirits." But, in depressed economic circumstances these will not materialise and the demand for cash will reflect uncertainty (precautionary demand) and the torpidity of the entrepreneurial environment, (see also Keynes's "liquidity

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available in the UK as it has surrendered its monetary autonomy to the Bundesbank. Debt deflation appears to make for a more protracted adjustment process. There is certainly a degree of similarity with the situation which prevailed during our period of study. With the significant exception that governments now accept that budgets be stabilised over the cycle and large welfare transfer payments maintain private sector consumption, both of which are crucial in preventing the sort of cumulative deflationary process which was evident in the 1930s, particularly in the US and to a lesser extent in France.

[167] see Hawtrey (1978). In a present day context the relative emphasis placed on the importance of currency or credit would lead one to focus either on MO and M1, or M4 as monetary targets and indicators.

trap"), rather than be a result of economic activity. Though if the level of credit demand is depressed, so will be income and the demand for (transactions) cash balances. Nevertheless, in such a climate open-market operations may be the only way to inject monetary liquidity into the financial system. However, if open-market policies fuelled uncertainty they might only have caused a shift in portfolio between the private sector and the Bank, i.e., the francs acquired by domestic agents against sale of *rentes* to the Bank being promptly exchanged for foreign assets (or gold) which the Bank would have to sell to maintain the fixed par of exchange. The ensuing fall in official reserves would further weaken the currency.

There is another aspect to France's large gold reserves aside from the question of legislation dictating the Bank of France's assets and gold inflows related to the repatriation of balances held off-shore, or precipitated by the uncertain outlook for other reserve currencies. That is the question of a strategic stockpile of gold. Ever since Pallain's governorship (1897-1920) it had been held as a rule-of-thumb that some 50 *milliards* francs should represent the minimum threshold for reserves.[168] There is no doubt that if French policy-makers had been pressed on this point, and were being candid, they would have recognised this. This was one among the three principal reasons identified by Sir Basil Blackett,- sometime Treasury mandarin and Director of the Bank of England from 1929-35,- which explained France's substantial gold reserves. Amongst the other two were national prestige, and the desire to replace the UK as a great financial centre.[169] Even the French authorities would have recognised that the latter was too ambitious. However, it is clear that France wanted to play as significant a role as the UK, and was intensely jealous of the Bank of England and its Governor Montagu Norman and of the Financial Committee of the League of Nations which Governor Moreau (1926-1930) had argued was in effect an instrument of British foreign policy (cf., Einzig). This rivalry was particularly apparent over the question of post-war east and central European stabilisation loans. And it is no coincidence that Poland was allowed membership of the Gold Bloc as well as loans to finance its railways in the mid-1930s. Poland was still counted on as part of France's security network to the east of Germany, now that its pre-war ally, Russia, was beyond the pale. The last reason

[168] Mouré (1991, p.255, footnote 78) quotes Netter who argued that the catalyst for devaluation in September 1936 was the fall in the gold reserve towards the FRF 50bn. strategic minimum.

[169] see RIIA (1931) pp.179-180.

adduced by Blackett to explain France's gold policy was the earlier experience with inflation and currency depreciation until the Poincaré stabilisation. There is no doubt that the latter explanation did condition French policy-makers' attitude towards any form of managed or artificial currency standard.[170]

With regard to the second reason adduced by Blackett, I think that this is a very important point. There is no doubt that French economic and financial policy-makers, certainly in the 1920s, wanted to re-establish France's role as a leading financial centre and, if possible, enhance it. And given that France had derived its previous status as a leading provider of funds, on the sovereign debt market, as a result of its high domestic savings rate, rather than as in the UK because of its role as the world's leading commodity, trade, and financial centre, it was only to be expected that the French authorities would wish to establish a gold bullion standard in order to secure domestic investor confidence, particularly after the fiscal, financial and currency debacle of the early post-war years,- after which all three were perceived to be closely inter-twined,- returning to gold would provide a guarantee and discipline against any recurrence. Furthermore, France could not expect its currency notes, or liabilities denominated in the national currency, to be held for their own sake, as were liquid claims against the world's two financial clearing centres, viz., the dollar and sterling. The liquidity and reserve demand for international vehicle currencies may be considered tantamount to *seigniorage*. If France wanted the franc to fulfil a similar role it would have to demonstrate real backing for the currency. The opportunity cost being the foregone interest on sterile gold reserves, in this context one could consider that the UK *seigniorage* was equivalent to the difference between the French and UK gold reserves and the interest which could have been earned if the balance of French gold reserves had been held in Treasury bills, adjusted for the relative size of liabilities outstanding in both currencies, so that if sterling liabilities were greater then the UK rate of *seigniorage* would be proportionally higher for any given relative level of reserves, i.e., the Bank of France had to hold a higher proportion of non-income earning assets against its liabilities than the Bank of England.

One should further add that France's "hoarding" of gold can be ascribed to its mercantilist tradition which may have something to do with the fact the France was still

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[170] see Eichengreen's Golden Fetters in particular.

substantially an agrarian country, i.e., because of the volatility of agricultural prices. It also had a contiguous border with its traditional foe, Germany, and needed immediate collateral, viz., gold, to pledge in order to raise balance of payments loans in case of war, or to finance exchange support operations, as occurred in the First World War. England, an island and trading nation, was reliant on its fleet and trade and, therefore, had a more liberal free trade ideology. Furthermore, as the centre of world trade finance, which is by its nature credit driven, the UK was more confident of its ability to trade on a narrow gold margin expectant that its credit standing would allow it to raise loans in case of conflict, and secure in the knowledge of substantial overseas assets. I think there is a case for arguing that geography does condition cultural and economic patterns of thought. It is interesting to note, though, that both liberal free trade ideology, which is synonymous with the gold standard,[171] and mercantilism were both obsessed with the exchanges to the detriment of the domestic economy. It is only in the latter half of the twentieth century, that concern shifted to the macro-economy and domestic stability, and some might argue that this concern has been extinguished by the current obsession with fixed (nominal) exchange rates and putative policy ineffectiveness.

[171] "Adherence to an international monetary standard at once implies and necessitates adherence to an international economic system. To impose artificial restrictions on the movement of goods is the negation of such a system," i.e., free trade and the gold standard are synonymous. From Gold Delegation Report, L.N., 1932, p.56.

CONCLUSIONS

This thesis has made plain the need to understand the course of French policy-making from an historical perspective. Following the protracted treasury and exchange crises of the period 1924-26 the need to avoid the repetition of such events had become engraved in the public consciousness. The talisman of this restored financial order was the franc's fixed gold parity. The Poincaré stabilisation had meant substantial sacrifice for the *rentiers*. This was a necessary, but unfortunate, adjustment to the burdens of the past, viz., war and reconstruction expenditure. It was a one off adjustment not to be repeated. The British devaluation of September 1931 was not an example for France to follow as it too consisted of a discrete adjustment to post-war economic realities.

The prevailing French interpretation of the currency instability of the 1920s has been shown to be an essential ingredient in understanding why the authorities rejected devaluation as an option in the 1930s. It was considered that during the 1920s the currency had been buffeted by speculative flows, that this undermined credibility in the currency and precluded funding of government borrowing. As a result the state had eventually to rely on the issue of short-dated Treasury bills and even covert advances from the Bank of France to finance its expenditure. Only a fixed gold parity could restore confidence in government finances and prevent a recurrence of these events.

This interpretation explains the controversial role of the Bank of France which has been much maligned. Governments both of the left and centre-right accused it of sabotaging its policies. However, the legislation of 1928 governing the note issue which mandated 35% gold reserves against notes and current accounts held at the Bank was deliberately enacted in order to make the currency issue independent of the political authorities. Our research has clearly demonstrated that the Bank did not deliberately undermine governments of the left, as was averred at the time, but followed orthodox policies which it considered consonant with maintaining the gold standard.

The principles which governed the Bank's activities were what have become known in economic history as the "banking principles." That is the currency should be backed only by gold (outside money) or "real" self-liquidating commercial bills (the so-called "real bills doctrine"). Moreau's memoirs are replete with references to the need to stick to these principles. However, the strictures governing the Bank's monetary policy had perverse effects in depression and meant that monetary policy was pro-cyclical. The French policy-making and banking establishment argued during the 1930s that its policies were not tight, pointing to the Bank's substantial gold reserves as evidence, but rather that sound bills were not being presented for discount.

British policy-makers, Hawtrey, Leith-Ross and Strakosch in particular, argued that the principles guiding French monetary policy were perverse. In the period from 1926 the desire on the part of French economic agents to reconstitute cash balances following stabilisation of the franc meant that they could only obtain funds by drawing balances held in foreign centres or gold, with the stabilisation of 1928 solely gold or real bills would do. This had sterilised international liquidity and helped undermine sterling. The British argued that France should have engaged in open-market operations in order to satisfy the additional demand for cash following stabilisation and stabilised nominal income by this means during the 1930s. The British political class adhered to what were in effect the "currency principles".

However, our analysis has clearly demonstrated that Hawtrey's constant demand that the Bank of France engage in open-market operations, whilst perhaps sound in pure economic terms, demonstrated a complete lack of understanding of France's post-war financial history. Given the experience of the 1920s when the Bank had first to discount *bons de la défense nationale* and later rediscounted Treasury bills (*avances occultes*) until it was even obliged to doctor its balance sheet in order to underestimate the number of notes in circulation to satisfy government financial demands, it was clear that open-market policies would have revived fears amongst the public that this policy was being renewed. Provisions to the effect that the Bank could and/or should purchase government bonds would surely have whetted the appetite of the government of the day, particularly during the 1930s when the policy of deflation confronted government with invidious choices between cutting expenditure and/or raising revenue. It is very likely that the Bank would have found itself swamped by demands for accommodation on the part of government. This, in turn, would have undermined its credibility and public reputation. The result would have been that the public would have sold the currency created through open-market operations for gold. The final outcome of the operation would have been a reshuffling of portfolios between the private sector and the Bank with the Bank the loser in case of devaluation.

In a sense the Bank was made the scape-goat for the fiscal impasse caused by the depression and the political cleavages running through the polity which made fiscal compromise virtually impossible. The political vehicle used to overcome the impasse would be the delegation of decree-making powers. This allowed parliament to exonerate itself from blame and as soon as the immediacy of the political or financial crisis had seen to have passed and the policies were becoming unpopular the decree-making mandate would not be renewed. A change in political personnel would follow, but the underlying problems remain.

Our thesis has also demonstrated that the orthodox opinions which informed policy-making in France formed part of a coherent political and economic paradigm, whilst those favouring devaluation could not muster as persuasive a model. Those favouring devaluation were also divided as to its effects, viz., that it would stimulate exports and those who argued that it would raise prices. Financial authorities, such as Germain-Martin, could point to the inconsistencies in these arguments.

It used to be the case that French policy-makers of the period were dismissed as ignorant in the economic field. This view which owed a lot to the post-war Keynesian ascendancy and was shared by Sauvy (1984) and later repeated by Kemp (1972) has been shown to be quite wrong. The current ascendancy of supply-side economics and new classical macro-economics provide a more congenial intellectual climate to reappraise the orthodox model.

Until early 1935 the policy-making establishment was convinced that a liberal economy needed a fixed anchor, namely the gold franc to allow the price mechanism to operate. The budget had to be balanced, or at least efforts should be made to do so, to maintain credibility of the fixed gold parity. The burden of fiscal adjustment should preferably fall on expenditure to reduce crowding-out, only then could the rate of interest be brought down and the government engage in a debt conversion and reduce debt servicing costs. Devaluation might bring temporary relief by stimulating economic activity but would lead to compensatory wage demands, viz., imported inflation. Wage demands would not be confined to the private sector, but would also be made by the public sector. This would add to the budget deficit. Once credibility had been eroded there was no telling what pressures the franc might come under. Furthermore subsequent governments might not be able to resist the temptation to devalue again and realise the profits which could be secured on the Bank's revalued gold reserves.

In other words the orthodox view was that once the "golden fetters" had been sundered this would invite a rake's progress in public finance. It is important to note that the worst apprehensions of the financially orthodox were realised once France devalued in September 1936.

This thesis has shown that it was not just post-war currency experience which differentiated British and French reactions to the depression, but that it rested on different analyses of the causes of the depression. French policy-makers, q.v., Aftalion, Rist and Rueff, argued that the depression was caused by post-war over-production. This had been precipitated by real factors, but also by the post-war credit boom which had been facilitated by the gold exchange standard. Therefore to prescribe further credit inflation, viz., open-market operations to combat depression, was wholly misplaced and would distort the price mechanism. British policy-makers *per contra*, and particularly Hawtrey, laid great emphasis on the need to stabilise the nominal macro-economic framework by maintaining the stability of the currency's domestic purchasing power. Earlier British experience with deflation had taught them that attempting to deflate the nominal price level was perverse and would result in falling output and widening budget deficits. The political costs of balancing the budget would be perceived by the market as unsustainable and force devaluation. The solution lay therefore in raising wholesale prices in line with retail prices, through devaluation and a relaxation of macro-economic policy, rather than attempt the converse as was attempted in France.

These conflicting policy prescriptions proved irreconcilable until France was forced to devalue.

Our thesis also demonstrates that though the US is often blamed for scuppering the London World Economic Conference, an agreement was neither possible (*pace* Roosevelt's less than diplomatic *communiqué*) nor desirable. It is clear that Roosevelt was forced to act as he did to respond to the domestic banking crisis and the more inflationary lobbies in Congress. Eichengreen's work has clearly demonstrated that providing accommodation to the banking system was incompatible with maintaining a free and fixed gold parity. The British government, though more diplomatic, was not willing to compromise its independent monetary policy, whilst France continued to insist that any agreement be premised on a commitment to an eventual return to gold.

The result was that France formed the Gold Bloc essentially as a defensive currency bloc as both the Dutch guilder and Belgian franc had come under pressure following Roosevelt's "bombshell". France's behaviour in constituting the Bloc was not altruistic for if any of the currencies remaining on gold were forced to devalue it was clear that speculation would turn to the franc. Furthermore, the existence of a West European gold currency bloc would increase diplomatic leverage aimed at re-establishing gold as the international currency standard. At London, and after, French policy-makers continued to be convinced that the UK could eventually be persuaded to return to gold. This seems to have been a continuous misreading of British intentions and, as such, must constitute a grave error of diplomatic policy judgment on the part of French officials. Our work has also demonstrated how mistrustful French, and for that matter British, officials were of any overtures on currency stabilisation coming from the US given the record of the Roosevelt administration in this field.

The failure of attempts to lend an economic dimension to the Gold Bloc are clearly shown to have been determined by two factors. The first being the difficulty of liberalising trade in a deflationary environment in which producer interest groups become more vocal. This applies particularly to the French agricultural sector which had been protected to insulate it from the twin shocks, or terms of trade effects, of weak world agricultural prices and an overvalued exchange rate. The second impediment to liberalisation was the most favoured nation clause which meant that any preferential trade concessions would have to be multilateralised. An additional handicap, frequently invoked by French policy-makers, was the Franco-British agreement of 1934 to make reciprocal any preferential trade concessions which they might extend to third parties. As a result of these constraints, negotiations to increase trade within the Gold Bloc were conducted on a purely mercantilist and bilateral basis. Nevertheless, we must conclude that the Gold Bloc was always too dependent on extra-Bloc trading relations for member states to risk compromising them by any unilateral measures, such as departure from MFN.

That the Gold Bloc was a failure was realised by French policy-makers by early 1935, in fact Flandin had made overtures to the British in January 1935 aiming at a currency stabilisation agreement and possible French devaluation with the prospect of French trade liberalisation as a *quid pro quo* for British assent. However, the British government was unwilling to compromise any of its currency autonomy ahead of the elections which would eventually be held in October 1935. Internal policy documents have shown that by March

1935 (the date of the Belgian devaluation) French policy-makers knew that a wider currency agreement would have to be reached with the anglo-saxon nations.

Why then did France continue with the Gold Bloc? The simple answer was that there appeared no viable alternative. French policy-makers had now come round to the view that the French franc would probably have to be devalued, but this could not be done outside an international agreement. Failing that, Britain might allow sterling to float down, and Roosevelt might use his power to reduce the gold value of the dollar from the prevailing 59% of its former gold parity to 50%. Both countries might also introduce retaliatory trade measures, as France had done following the British and other devaluations of 1931. Until such an agrement could be reached France would not devalue. In addition the campaign waged in France, by the Bank of France and large sections of the policy-making establishment, against those lobbying in favour of devaluation had been successful, as Mouré (1991) has argued, and a party advocating devaluation would not have won the elections in 1936.

Nevertheless, one might ask along with Kaleçki (1938), why didn't the Popular Front introduce exchange controls when it came to office in June 1936? The answer is twofold, namely that the Popular Front did not wish to isolate itself from the democracies in the increasingly polarised international environment which then prevailed, but, perhaps, more importantly the Popular Front consisted of a heterogeneous coalition of radicals, socialists and communists. The radicals would not have supported exchange controls. This prompts the question why Blum did not renege on his electoral promise and simply devalue blaming it on his predecessors? Again the answer is that he would not have obtained agreement from the coalition which supported him. Neither the radicals nor the communists would have supported it. The communists thought of devaluation as a means of eroding the gains which the working class had made as a result of the Matignon agreements. And the radicals were opposed on the grounds that it would penalise small-savers, as were the communists interestingly enough. Furthermore, Blum needed a diplomatic guise to make such a policy reversal more palatable; hence, the negotiations which he initiated aimed at securing an agreed French devaluation within a broader Tripartite stabilisation accord as soon as he came to office.

Drummond's work (1979) has shown that despite its efforts France failed to secure the firm commitment of a return to gold which it had always sought.

When Blum did devalue he sent all the wrong policy signals, slashing interest rates, increasing public expenditure and taxing "speculative exchange profits". However, it is too easy to simply blame Blum for his manifest policy incompetence in the financial field. The Popular Front government inherited, much as did the *Cartel des Gauches* in 1924, a political, social, economic, financial, budgetary, and exchange crisis. This was compounded by a fast deteriorating international situation. The fact that there was a one month inter-regnum between the elections and when Blum took office made the situation only worse.

Political instability only exacerbated the various financial crises which France endured during the inter-war years. Had the executive or presidency been able to dissolve the legislature when it was clear that parliament was no longer representative of the country at large, or when a lasting majority in parliament could no longer be found to pursue a given policy, such as the policy of deflation after the fall of the Laval government in January 1936, then political and financial crises might not have been as protracted. This judgment applies equally to the crises of 1925, and 1937. Though this should be qualified by a crucial conclusion of our study of the French polity, namely that divisions ran as fault-lines through it and the position of the radicals at the centre of the political spectrum rather than lend it an equilibrating centre of gravity destabilised the polity. This was due to the radicals' schizophrenic position torn as they were between electoral expediency and republican affinities to side with the left, and their orthodox financial views which drew them toward the centre-right. The communists refused any political co-operation with the left until the Franco-Russian foreign policy *rapprochement* initiated by Laval in 1935.

The paradox of the electoral success of the Popular Front is that it owed part of its appeal to the failure of the orthodox policies pursued by Laval in the name of economic liberalism and protecting the franc's gold parity. This led to a far greater departure from liberal principles than would be witnessed under the Popular Front, such as the alteration of contractual relations by administratively reducing rents and coupon payments.

That France should have avoided devaluation so long was due to the fact that her gold reserves were so large, and from a political perspective that unemployment never rose to the heights reached in Germany, the US, or UK.

The novelty of this thesis rests on carrying on the historiographic research project begun with Eichengreen (1982; 1985; *et.al.*), Jackson (1985), Eichengreen & Wyplocz (1986), and now Mouré (1991) which aims to understand policy making in France from a domestic perspective and the historical antecedents which informed policy-makers. That is to open up the *ceteris paribus* clause and understand the constraints within which policy was made.

It is clear that the traditional appraisal of French policy must prevail, viz., that it was a failure. And that France should have suspended the gold standard and pursued a policy aimed at stabilising nominal demand.

However, our thesis has made clear that many of the other suggested policy alternatives, such as open-market policies, marked a lack of understanding of post-war experience and the fractured polity which confronted with an invidious choice between reducing budgetary expenditure or forcing the central Bank to discount government securities would, in our judgment, have chosen the latter course. When the Poincaré franc was abandoned this is exactly what happened. The crisis was not just caused by inappropriate monetary policies, but was compounded by weak government and a deeply fractured polity.

Hopefully our thesis will also have served to explode one of the abiding myths of inter-war historiography, namely that currency depreciation and protection went hand-in-hand in a form of beggar-my-neighbour policy, with the direction of causation running from the former to the latter. Rather, a more cogent interpretation is that fixed gold parities forced governments to protect powerful interest groups and economic activity from the effects of imported deflation. Countries beggared themselves by not devaluing, not the other way round.

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APPENDICES

TABLE A-1

Indicators of Comparative Economic Performance, France, UK, USA (1913-39):

	France	UK	US	France	UK	US
	year-on-year GDP			consumer prices		
1913	100.0	100.0	100.0			
1914				100.0	100.0	100.0
1918	-36.1	13.2	14.8	113.0	100.0	22.5
1919	17.8	-10.9	0.9	25.8	9.5	14.2
1920	15.7	-6.1	-1.0	38.4	13.2	0.5
1921	-4.1	-8.1	-2.3	-10.2	-9.7	-12.9
1922	18.0	5.2	5.5	-5.4	-19.2	-2.4
1923	5.2	3.2	13.2	9.2	-2.8	1.8
1924	12.5	4.1	3.1	14.8	00.0	00.0
1925	0.4	4.9	2.3	7.3	00.0	3.0
1926	2.6	-3.7	6.5	32.0	-2.8	-1.2
1927	-2.1	8.1	1.0	5.9	-2.3	-2.3
1928	7.0	1.2	1.2	-1.5	00.0	-1.2
1929	6.7	2.9	6.2	6.3	00.0	00.0
1930	-2.9	-0.7	-9.5	-0.5	-6.0	-2.4
1931	-5.9	-5.1	-8.3	-1.5	-5.7	-8.7
1932	-6.5	0.8	-13.4	-10.3	-3.4	-10.9
1933	7.2	2.9	-2.1	-4.8	00.0	-5.3
1934	-1.0	6.6	7.9	-5.6	00.0	4.0
1935	-2.6	3.9	8.0	-10.4	00.0	2.3
1936	3.8	4.5	14.3	9.1	3.5	1.5
1937	5.8	3.5	4.9	27.3	2.7	3.0
1938	-0.4	1.2	-4.6	15.5	3.3	-1.5
1939	7.2	1.0	7.9	8.1	3.2	-1.5

Source: A.Maddison (1991) Appendices A and E.

TABLE A-2

COMPETITIVENESS OF FRENCH EXCHANGE RATE WITH STERLING 1913-38:

(compared with 1913)

	I	II	III	IV	V	VI
1913	25.21	100	25.21	100	25.21	0%
1920	58.97	370	15.94	248	39.53	-36%
1921	51.62	332	15.55	224	34.83	-28%
1922	54.05	314	17.21	181	31.15	-19%
1923	75.39	343	21.98	176	38.68	-35%
1924	84.49	393	21.50	176	37.84	-33%
1925	101.21	422	23.98	176	42.40	-40%
1926	149.95	558	26.87	171	45.95	-45%
1927	124.02	591	20.98	167	35.04	-28%
1928	124.02	582	21.31	167	35.59	-29%
1929	123.90	619	20.02	167	33.43	-25%
1930	124.02	616	20.13	157	31.60	-20%
1931a	123.06	607	20.27	148	30.00	-16%
1931b	93.41	607	15.39	148	22.78	11%
1932	89.24	544	16.40	143	23.45	8%
1933	84.24	518	16.26	143	23.25	8%
1934	76.68	489	15.68	143	22.42	12%
1935	74.26	438	16.95	143	24.24	4%
1936	81.36	478	17.02	148	25.19	0%
1937	122.05	609	20.04	152	30.46	-17%
1938	184.45	703	26.24	157	41.20	-39%

a: January-September 1931; b: October-December 1931.

Column I: exchange rate FRF/GBP; II: French cost of living index; III: exchange rate divided by cost of living index; IV: UK cost of living index; V: real exchange rate adjusted for UK price level; VI: percentage depreciation (-) or appreciation of the franc real exchange rate against sterling relative to 1913.

Source: first column Svennilson (1954, p.318) derived from taking cross rate between franc/dollar rate and sterling/dollar rate; second and fourth columns from A.Maddison (1991, pp. 300-303 rebased on 1913.

TABLE A-3

COMPETITIVENESS BRITISH EXCHANGE RATE WITH THE DOLLAR 1913-38:

(compared with 1913)

	I	II	III	IV	V	VI
1913	.2055	100	.2055	100	.2055	0%
1920	.2861	248	.1154	191	.2204	-7%
1921	.2598	224	.1160	167	.1937	6%
1922	.2259	181	.1248	163	.2034	1%
1923	.2186	176	.1242	166	.2062	0%
1924	.2263	176	.1286	166	.2135	-4%
1925	.2071	176	.1177	171	.2013	2%
1926	.2058	171	.1204	169	.2035	1%
1927	.2057	167	.1232	165	.2033	1%
1928	.2057	167	.1232	163	.2068	2%
1929	.2059	167	.1233	163	.2010	2%
1930	.2057	157	.1310	159	.2083	-1%
1931a	.2073	148	.1401	145	.2031	1%
1931b	.2731	148	.1845	145	.2675	-23%
1932	.2852	143	.1994	129	.2572	-20%
1933	.2360	143	.1651	122	.2014	2%
1934	.1985	143	.1388	127	.1763	17%
1935	.2040	143	.1427	130	.1855	11%
1936	.2012	148	.1359	132	.1794	15%
1937	.2023	152	.1331	136	.1810	14%
1938	.2045	157	.1303	134	.1746	18%

a: January-September 1931; b: October-December.

Column I: exchange rate sterling/dollar (annual average); column II: UK cost of living index; column III: exchange rate divided by cost of living index; column IV: US cost of living index; column V: real exchange rate adjusted for dollar price level; column VI: percentage real depreciation(-) or appreciation of sterling against the dollar.

Source: same as table A-2.

TABLE A-4:

COMPETITIVENESS OF FRENCH EXCHANGE RATE WITH THE DOLLAR 1913-38:

(compared with 1913)

	I	II	III	IV	V	VI
1913	5.18	100	5.18	100	5.18	0%
1920	16.87	370	4.56	191	8.71	-41%
1921	13.41	332	4.04	167	6.75	-23%
1922	12.21	314	3.89	163	6.34	-18%
1923	16.48	343	4.80	166	7.97	-35%
1924	19.12	393	4.87	166	8.08	-36%
1925	20.96	422	4.97	171	8.50	-39%
1926	30.86	558	5.53	169	9.35	-45%
1927	25.51	591	4.32	165	7.13	-27%
1928	25.51	582	4.38	163	7.14	-27%
1929	25.51	619	4.12	163	6.72	-23%
1930	25.51	616	4.14	159	6.58	-21%
1931	25.51	607	4.20	145	6.09	-15%
1932	25.45	544	4.68	129	6.04	-14%
1933	19.88	518	3.84	122	4.68	11%
1934	15.22	489	3.11	127	3.95	31%
1935	15.15	438	3.46	130	4.50	15%
1936	16.37	478	3.42	132	4.51	15%
1937	24.69	609	4.05	136	5.51	-6%
1938	37.72	703	5.37	134	7.20	-28%

Column I: FRF/USD exchange rate; column II: French cost of living index; column III: exchange rate divided by cost of living index; column IV: US cost of living index; column V: real exchange rate adjusted for dollar price level; column VI: appreciation or depreciation (-) of the real franc exchange rate against the dollar.

Source: same as table A-2.

TABLE A-5:

ANNUAL AVERAGE BANK OF FRANCE DISCOUNT RATE:

1913	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928
4.00	5.00	5.73	5.79	5.11	5.00	5.99	6.33	6.58	5.22	3.53

1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939
3.50	2.72	2.11	2.50	2.50	2.70	3.40	3.67	3.81	2.76	2.00

Source: A.Sauvy (1984) Histoire économique de la France (vol.III, p.404).

TABLE A-6:

TRADE RELATIONS BETWEEN AND OUTSIDE THE GOLD BLOC:

(millions of Swiss francs)

	I	II	III
1928	13,215	45,426	29.1%
1929	13,244	46,528	28.5%
1930	11,885	39,344	30.2%
1931	9,568	29,901	32.0%
1932	6,458	20,188	32.0%
1933	5,918	18,950	31.2%

Column I: value of trade within the gold bloc (purchases and sales); Column II: value of trade conducted outside the gold bloc (purchases and sales); Column III: percentage of internal to extra gold bloc trade.

Source: "*Chiffres essentiels du commerce des "Pays du Bloc-or*", p.18, League of Nations, Geneva 8/3/35.

TABLE A-7 (a):

BALANCE OF TRADE OF BELGO-LUXEMBURG UNION

with the gold bloc and principal trading partners:
(millions of Belgian francs)

	1928	1929	1930	1931	1932	1933	1934 *
France	-2,699	-2,923	-1,395	-102	272	385	122
Italy	278	457	229	236	141	161	159
Netherlands	413	-91	-699	-545	-381	21	185
Poland	57	108	68	-10	0	-8	-118
Switzerland	474	414	286	375	419	355	312
Total	-1,477	-2,035	-1,511	-46	451	914	660
Germany	251	-1,096	-2,194	-1,657	-1,195	-1,016	-371
United Kingdom	1,630	1,826	2,160	2,962	954	420	784
United States	-676	-1,252	-1,817	-950	-696	-484	-443
Others	-834	-1,187	-1,573	-1,101	-733	-723	-845
Total balance	-1,106	-3,744	-4,935	-792	-1,219	-889	-215

* estimate.

Source: "*Chiffres essentiels du commerce des Pays du Bloc-Or,*" L.N. (1935).

TABLE A-7 (b):

FRENCH BALANCE OF TRADE

with the gold bloc and principal trading partners:
(millions of French francs)

	1928	1929	1930	1931	1932	1933	1934
Belgo-Luxemburg Union	3,915	3,305	1,243	-51	-207	174	412
Italy	659	693	154	-445	-35	-130	42
Netherlands	-362	-390	-531	-682	-435	-189	-84
Poland	218	167	79	-158	86	-32	-26
Switzerland	2,293	2,308	1,962	1,405	904	698	725
Total	6,723	6,083	2,907	69	313	521	1,069
Germany	619	-1,879	-3,782	-3,393	-1,914	-1,341	-451
United Kingdom	2,584	1,745	1,572	1,319	-494	-491	-174
United States	-3,144	-3,825	-3,713	-2,258	-1,943	-1,983	-1,525
Others	-10,890	-12,897	-9,151	-8,715	-6,246	-6,147	-5,193
Total balance	-4,108	-10,773	-12,167	-12,978	-10,284	-9,441	-6,274

Source: same as table A-7 (a)

TABLE A-7 (c):

ITALIAN BALANCE OF TRADE

with the gold bloc and principal trading partners:
(in millions of lira)

	1928	1929	1930	1931	1932	1933	1934 *
Belgo-Luxemburg Union	-333	-240	-112	-81	-75	-82	-104
France	-698	-740	-270	294	32	48	-74
Netherlands	-137	-45	18	11	11	35	22
Poland	-4	29	-6	-12	-13	13	12
Switzerland	442	502	381	370	269	213	209
Total	-730	-494	11	582	224	227	65
Germany	-354	-898	-1,032	-444	-327	-359	-352
United Kingdom	-390	-579	-487	102	-1	-43	-363
United States	-2,490	-1,843	-1,211	-281	-473	-595	-623
Others **	-3,397	-2,605	-2,509	-1,392	-869	-663	-1,201
Total balance	-7,361	-6,419	-5,228	-1,433	-1446	-1,433	-2,474

* figures based on average for first eight months of 1934.
** includes colonial trade.

Source: same as table A-7 (a).

TABLE A-7 (d):

DUTCH BALANCE OF TRADE

with the gold bloc and principal trading partners:
(millions of guilders)

	1928	1929	1930	1931	1932	1933	1934 *
Belgo-Luxemburg Union	-128	-78	-63	-24	-17	-24	-31
France	3	4	32	41	31	19	12
Italy	19	9	--	-4	-3	-3	--
Poland	-4	-6	-15	-15	-9	-9	-8
Switzerland	1	-2	2	-2	7	5	5
Total	-109	-73	-44	-4	9	-12	-22
Germany	-262	-386	-402	-364	-221	-222	-120
United Kingdom	180	150	156	161	42	17	42
United States	-197	-201	-162	-114	-57	-45	-57
Others	-310	-253	-247	-260	-226	-221	-186
Total balance	-698	-763	-699	-581	-453	-483	-343

* estimate.

Source: same as table A-7 (a).

TABLE A-7 (e):

POLISH BALANCE OF TRADE

with the gold bloc and principal trading partners:
(millions of zloty)

	1928	1929	1930	1931	1932	1933	1934 *
Belgo-Luxemburg Union	-10	-5	7	21	21	18	20
France	-206	-153	-76	-7	3	-3	-4
Italy	-34	-44	-39	-14	4	-13	-3
Netherlands	-61	-34	5	27	21	25	15
Switzerland	-72	-65	-33	-25	-13	-13	-9
Total	-383	-301	-136	2	36	14	19
Germany	-44	27	21	-41	3	22	63
Austria	90	114	100	100	48	21	14
United Kingdom	-86	-27	116	214	103	102	114
United States	-448	-353	-249	-142	-94	-94	-99
Czecho-Slovakia	83	68	46	44	44	12	20
Others	-66	174	290	237	82	56	20
Total balance	-854	-298	188	411	222	133	151

* estimate.

Source: same as table A-7 (a).

TABLE A-7 (f):

SWISS BALANCE OF TRADE

with the gold bloc and principal trading partners:
(millions of Swiss francs)

	1928	1929	1930	1931	1932	1933	1934
Belgo-Luxemburg Union	-51	-34	-30	-42	-46	-39	-28
France	-334	-308	-269	-206	-149	-102	-108
Italy	-59	-45	-65	-86	-61	-54	-40
Netherlands	1	7	3	--	-25	-13	-13
Poland	26	14	-2	-2	-9	-2	-2
Total	-417	-366	-363	-336	-290	-210	-191
Germany	-237	-343	-426	-462	-388	-322	-207
United Kingdom	80	120	31	140	8	-3	-7
United States	-49	-83	-61	-72	-60	-32	-29
Others	12	-8	-77	-172	-232	-174	-157
Total balance	-611	-680	-896	-902	-962	-741	-591

Source: same as table A-7 (a).

TABLE A-8:

EXPORTS OF GOLD BLOC STATES TO ONE ANOTHER AND THE WORLD AT LARGE FROM 1929-1933:

(in millions of national currency)

	I		II		III	
	1929	1933	1929	1933	1929	1933
Belgium	9,625	5,633	31,038a	14,179a	31.0	39.7
France	14,074	4,606	40,647b	12,460b	34.7	37.0
Italy	2,825	1,214	14,884	5,980	18.9	20.3
Netherlands	385	205	1,807c	695c	21.4	29.7
Switzerland	463	279	2,104	853	22.0	32.8

a: excluding the Belgian Congo; b: excluding protectorates and French colonies; c: excluding the Netherlands East Indies.

Source: *"Résultats de mes conversations en Belgique, aux Pays-Bas, en Suisse et en Italie, relativement à la possibilité d'un accord économique entre les cinq pays à étalon or de l'Europe Occidentale (Avril 1934)"*, dated Geneva, 10/5/34, in, M.F., B 32 323.

TABLE A-9:

THE BEHAVIOUR OF M2 OVER THE INTER-WAR YEARS:
(annual percentage variation)

1919	1920	1921	1922	1923	1924	1925	1926	1927	1928
12.4%	0.6%	-0.7%	4.6%	8.7%	10.8%	25.4%	6.5%	6.4%	24.8%

1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
5.7%	5.6%	-0.7%	-3.2%	-1.2%	4.9%	-1.3%	-0.5%	11.3%	10%

Source: Lutfalla and Patat (1986) Histoire monétaire de la France au XX siècle. M2 is defined as notes in circulation; commodity money (gold and silver); deposits: in postal savings accounts, at the Treasury (only in the post-1945 period), and with the banks (cf., op. cit., p.238).

TABLE A-10:

HEADS OF GOVERNMENT, FINANCE AND BUDGET MINISTERS, AND GOVERNORS OF THE BANK OF FRANCE FROM 1919-39:

	I	II	III
17/11/1917- 18/1/1920	G.Clémenceau *(Gauche démocratique)*	Klotz *(radical socialiste)*	G.Pallain (1897-1920)
20/1/1920- 18/2/1920	A.Millerand *(non inscrit)*	François-Marsal *(non parlementaire)*	
18/2/1920- 23/9/1920	A.Millerand *(non-inscrit)*	François-Marsal *(non parlementaire)*	C.G.Robineau (appted. 25/8/20)
25/9/1920- 12/1/1921	G.Leygues *(républicain de gauche)*	François-Marsal *(non parlementaire)*	
16/1/1921- 12/1/1922	A.Briand *(républicain socialiste)*	Paul Doumer *(gauche démocratique)*	
15/1/1922- 26/3/1924	R.Poincaré *(union républicaine)*	C. de Lasteyrie *(entente républicaine et démocratique)*	
29/3/1924- 01/6/1924	R.Poincaré *(union républicaine)*	François-Marsal *(union républicaine)*	
09/6/1924- 13/6/1924	François-Marsal *(union républicaine)*	François-Marsal	
15/6/1924- 10/4/1925	E.Herriot *(radical socialiste)*	Clémentel *(gauche radicale)*	
17/04/1925- 27/10/1925	P.Painlevé *(républicain socialiste)*	J.Caillaux *(non parlementaire)*	
29/10/1925- 22/11/1925	P.Painlevé *(républicain socialiste)*	P.Painlevé (Finance) G.Bonnet (Budget) *(radical socialiste)*	
28/11/1925- 06/03/1926	A.Briand *(républicain socialiste)*	L.Loucheur *(républicain socialiste)*	

09/03/1926- 15/06/1926	A.Briand (*républicain socialiste*)	R.Péret (*gauche radicale*)	
24/06/1926- 17/07/1926	A.Briand (*républicain socialiste*)	J.Caillaux (*gauche démocratique*)	E.Moreau (appted. 26/6/26)
20/07/1926- 21/07/1926	E.Herriot (*radical socialiste*)	A. de Monzie (*gauche démocratique*)	
23/07/1926- 06/11/1928	R.Poincaré (*union républicaine*)	R.Poincaré	
11/11/1928- 27/07/1929	R.Poincaré (*union républicaine*)	H.Chéron (*union républicaine*)	
29/07/1929- 22/10/1929	A.Briand (*républicain socialiste*)	H.Chéron (*union républicaine*)	
02/11/1929- 17/02/1930	A.Tardieu (*républicain de gauche*)	H.Chéron (*union républicaine*)	
21/02/1930- 25/02/1925	C.Chautemps (*radical socialiste*)	C.Dumont (*gauche démocratique*)	
02/03/1930- 04/12/1930	A.Tardieu (*républicain de gauche*)	P.Reynaud (*action démocratique et sociale*)	L.L.C.Moret (appted. 25/9/30)
13/12/1930- 22/01/1931	T.Steeg (*gauche démocratique*)	L.Germain-Martin (Finance) (*gauche radicale*) M.Palmade (Budget) (*radical socialiste*)	
27/01/1931- 13/06/1931	P.Laval (*non inscrit*)	P.-E.Flandin (Finance) (*républicain de gauche*) F.Piétri (Budget) (*républicain de gauche*)	
13/06/1931- 12/01/1932	P.Laval (*non inscrit*)	P.-E.Flandin (Finance) F.Piétri (Budget)	
14/01/1932- 16/02/1932	P.Laval (*non inscrit*)	P.-E.Flandin (Finance) F.Piétri (Budget)	
20/02/1932- 10/05/1932	A.Tardieu (*républicain de*	P.-E.Flandin (*républicain de gauche*)	

	gauche)		
03/06/1932- 14/12/1932	E.Herriot (*radical socialiste*)	L.Germain-Martin (Finance) M.Palmade (Budget)	
18/12/1932- 28/01/1933	Paul-Boncour (*non inscrit*)	H.Chéron (*union républicaine*)	
31/01/1933- 24/10/1933	E.Daladier (*radical socialiste*)	G.Bonnet (Finance) (*radical socialiste*) L.Lamoureux (Budget) (*radical socialiste*)	
26/10/1933- 23/11/1933	A.Sarraut (*gauche démocratique*)	G.Bonnet (Finance) A.Gardey (Budget) (*gauche démocratique*)	
26/11/1933- 27/01/1934	C.Chautemps (*radical socialiste*)	G.Bonnet (Finance) P.Marchandeau (Budget) (*radical socialiste*)	
30/01/1934- 7/02/1934	E.Daladier (*radical socialiste*)	F.Piétri (*républicain de gauche*) P.Marchandeau from 4/2/34	
09/02/1934- 08/11/1934	G.Doumergue (non parlementarian)	L.Germain-Martin (*gauche radicale*)	
08/11/1934- 31/05/1935	P.-E.Flandin (*républicain de gauche*)	L.Germain-Martin (*gauche radicale*)	J.-S.Tannery (appted. 3/1/35)
01/06/1935- 04/06/1935	F.Bouisson (*non inscrit*)	J.Caillaux (*gauche démocratique*)	
07/06/1935- 22/01/1936	P.Laval (*non inscrit*)	M.Régnier (*gauche démocratique*)	
24/01/1936- 04/06/1936	A.Sarraut (*gauche démocratique*)	M.Régnier (*gauche démocratique*)	
04/06/1936- 21/06/1937	L.Blum (*SFIO*)	V.Auriol Minister of Finance (*SFIO*) C.Spinasse (*Economie Nationale*) (*SFIO*)	de Labeyrie (appted. 4/6/36)

22/06/1937- 14/01/1938	C.Chautemps (*gauche démocratique*)	G.Bonnet (*radical socialiste*)	P.-E.Fournier (appted. 21/7/37 to 31/8/40)
18/01/1938- 10/03/1938	C.Chautemps (*gauche démocratique*)	G.Bonnet Minister of State in charge of coordinating economic and financial policy P.Marchandeau (Finance) (*radical socialiste*)	
13/03/1938- 08/04/1938	L.Blum (*SFIO*)	L.Blum (Treasury Minister) C.Spinasse (Budget) (*socialiste*)	
10/04/1938- 20/03/1940	E.Daladier (*radical socialiste*)	P.Marchandeau (*radical socialiste*) replaced on 1/11/38 by P.Reynaud	

Column I: Presidents of the Council (of ministers)
Column II: Ministers of Finance and Budget, unless specified incumbent held both offices
Column III: Governors of the Bank of France

TABLE A-11

PRESIDENTS OF THE REPUBLIC:

18/02/1913-18/02/1920	R.Poincaré
18/02/1920-21/09/1920	P.Deschanel
23/09/1920-11/06/1924	A.Millerand
13/06/1924-13/06/1931	G.Doumergue
13/06/1931-07/05/1932	P.Doumer
10/05/1932-11/07/1940	A.Lebrun

Sources for tables: Bonnefous (1960) Histoire politique de la Troisième République; Soulier (1939) L'Instabilité ministérielle sous la Troisième République; Mayeur (1984) La vie politique sous la Troisième République; and *dossiers gouverneurs* at the Bank of France.

TABLE A-12:

COMPOSITION OF THE FIVE INTER-WAR CHAMBERS OF DEPUTIES:

	1919		1924
Bloc National	338	*Bloc National*	229
Centre	75	*Centre*	47
Gauche	197	*Cartel des Gauches*	266
	---	*Communistes*	26
	610		---
			568

	1928		1932
Conservateurs et Fédération républicaine.	160	*Droite*	127
Radicaux indépendants et républicains de gauche.	147	*Droite modérée*	48
Radicaux-socialistes	120	*Démocrates populaires*	14
Républicains-socialistes	47	*Républicains socialistes*	33
Socialistes	100	*Gauche modérée*	72
Socialistes communistes	2	*Radicaux socialistes*	151
Communistes	14	*Socialistes*	130
Indépendants et divers	3	*Communistes dissidents*	10
	---	*Communistes agrariens*	0
	593	*Autonomistes et divers*	20

			615

	1936
Front National	222
Front Populaire:	
Radicaux socialistes	109
U.S.R. et apparentés	56
Socialistes SFIO	149
Communistes	72

	608

Source: Soulier (1939) L'instabilité ministérielle sous la Troisième République (1871-1938), pp.516-517.

DOCUMENT A-1

BRITISH DECLARATION OF POLICY AT THE LONDON CONFERENCE

I should like to emphasise our view that there is a close connection between the monetary, financial and economic aspects of our problem, and that action must be taken simultaneously in all these spheres.

This is well illustrated by the first proposition which I should like to submit to you, namely, that it is essential to bring about a recovery in the world level of wholesale commodity prices sufficient to yield an economic return to the producers of primary commodities and to restore equilibrium between costs and prices of production, generally. It is clear that the present lack of equilibrium between prices and costs can only be remedied either by a further drastic reduction of wages and other costs and by widespread bankruptcies, or by a sufficient recovery in the level of wholesale prices.

In the opinion of the United Kingdom delegation, an attempt to obtain equilibrium by further large reductions of cost would be attended by intolerable suffering and holds out no hope of success. No doubt it would be possible to restore equilibrium between prices and costs by reducing costs if only prices would remain steady. Under present conditions that does not happen, but, on the contrary, an all-round reduction in costs produces further deflationary effects on prices, so that costs and prices chase one another downwards without ever getting to equilibrium. Moreover, there is one all-important entity in each country which finds it particularly difficult to reduce its own costs; I mean the central government. Every finance minister in the world knows only too well how tremendously resistant public expenditure is to reduction, if only for the reason that so many of its obligations are fixed in terms of money. A policy of reducing costs and prices has the inevitable effect of very greatly reducing the national income, with the consequence that, in order to balance its accounts, the government must take by taxation a larger and larger proportion of the income of the country. Sooner or later, usually sooner, this process is found to be intolerable, and countries bent on securing heavy reductions in costs and prices find that they have merely secured an unbalanced budget for which no practical cure can be found. In the view of the British delegation, therefore, a solution of our present difficulties must be found by means of a recovery in the price level.

To bring about a recovery in prices, action in various spheres will be necessary. The final settlement of reparations and war debts is not within the scope of this conference, but such a settlement is essential if the measures taken in other fields are to be effective.

As regards these, a number of reforms are required in the financial sphere; for example, the abrogation of exchange controls and the resumption of international lending; and also in the economic sphere, such as the co-ordination of production and marketing, the removal of prohibitions and similar barriers, and the reduction of excessive tariffs in order to permit a normal flow of international trade. I will refer to these later.

But, in order to attain the object of a recovery in prices, action is also necessary in the monetary sphere. The fundamental monetary condition of the recovery of prices is that credit should be made available by a policy of cheap money and that such credit should be actively employed. This, together with the revival of business confidence, must form the indispensable background of trade recovery.

The control of monetary policy is largely in the hands of the central banks and the practical steps to give effect to the requisite monetary policy have to be taken by them, and in particular by those of the most important financial centres. These central banks should therefore undertake to co-operate with a view to securing the monetary conditions required for a rise in prices. In order that their action may have the desired effect, it is necessary that the policy of cheap and plentiful money should be clearly announced and vigorously pursued. Particularly, the wider extension of what is known as "open market operations" by central banks should, in our view, be developed.

Experience in recent months has shown that cheap money in itself may not be enough to achieve the desired end rapidly unless means are taken to ensure that the credit made available is actively employed. This in turn depends upon the establishment of a sense of security and confidence in the public, and so again it is seen how inextricably finance and politics are intermingled.

The question whether governments can effectively assist in this matter by schemes of government capital expenditure will also require consideration. The United Kingdom delegation will be very ready to examine with other delegations how far employment can be stimulated by such action. In our view, however, it would be a mistake to attempt to lay down any rigidly uniform policy for different countries on this point. The extent to which employment can be stimulated by government capital expenditure necessarily depends upon the circumstances of each country, and, in particular, upon the extent to which opportunities are still open for self-supporting schemes, which in turn must depend partly upon the extent to which in each country schemes have already been promoted in the past. Each government must therefore determine, in the light of the situation in its own country, the size and nature of any further programme which it can wisely promote, and the method by which it should be financed.

A further matter which falls within the monetary sphere concerns the values of the principal currencies of the world in relation to each other. As the greatest international traders in the world, we fully recognise the great importance to international trade of stability of exchange rates. In our opinion, the attainment of this object must necessarily be attempted in two stages. The immediate objective should be to secure approximate stability between the currencies of the principal countries of the world in order that trade may not be hampered by violent and unpredictable fluctuations of what I may call the basic currencies. This end will be achieved in so far as the principal countries use their resources in order to counteract fluctuations in the value of their currency caused by temporary movements of capital rather than by fundamental economic factors.

This first stage should be dealt with immediately. As regards the second stage, the United Kingdom delegation endorse the view that the ultimate aim of monetary policy should be the restoration of a satisfactory international standard, and there is no doubt that a gold standard seems to be generally acceptable. The time and the exchange parity at which a return to gold could be safely made, must, as was pointed out in the Annotated Agenda prepared by the Preparatory Commission, fall to be determined by the proper authorities in each country separately, but in order that all countries may work harmoniously towards the same goal I have no doubt that the conference would wish me to state, in as positive and concrete terms as possible, the conditions under which the United Kingdom would feel justified in returning to the gold standard.

One of these conditions is a rise in the general level of the wholesale prices of commodities sufficient to restore equilibrium between prices and costs.

A second condition is an adjustment of the factors which caused the breakdown of the gold standard in the past and which, if not corrected, would inevitably lead to a repetition of the process in the future. These factors include, of course, the disturbances due to reparations and war debt payments, and the obstacles to international trade caused by excessive tariffs, exchange restrictions, and other abnormal impediments to the flow of commerce.

A third condition is that the gold standard shall in the future be so administered that wide fluctuations in the purchasing power of gold (in so far as they arise from monetary causes) will be to the greatest possible extent prevented. Without entering in detail into the question of the requisite reforms in the working of the gold standard (in regard to which I hope that a substantial measure of international agreement will be found to exist) I will only mention three which seem to us essential, namely the withdrawal of gold from internal circulation and its use only for settlement of international balances; the reduction in the legal minimum proportions of gold which central banks are required to hold in their reserves; and a closer permanent co-operation between central banks.

Source: Pasvolsky (1933), Appendix D, pp.163-166, "Excerpts from speech delivered at the conference June 14 by the British Chancellor of the Exchequer."

DOCUMENT A-2

PROJET DE DECLARATION COMMUNE DES GOUVERNEMENTS DES PAYS DONT LES MONNAIES SONT AU REGIME DE L'ETALON OR ET DES PAYS DONT LES MONNAIES NE SONT PAS A CE REGIME:

I. Les Gouvernements soussignés déclarent:

a. qu'il est de l'intérêt de tous de réaliser, aussi rapidement que possible la stabilité dans le domaine monétaire international;

b. que l'or doit être rétabli comme étalon monétaire international, la date et la parité auxquelles chacun des pays dont la monnaie n'est pas actuellement rattachée à l'or pourra entreprendre de stabiliser devant être décidées par les Gouvernments intéressés.

II. Les Gouvernements signataires dont la monnaie est sous le régime de l'étalon or confirment leur volonté de maintenir le libre fonctionnement de ce régime, aux parités or actuelle, dans le cadre de leurs lois monétaires respectives.

III. Les Gouvernements signataires dont la monnaie n'est pas sous le régime de l'étalon or, sans préjuger d'aucune manière les parités futures de leurs propres monnaies par rapport à l'or prennent note de la déclaration ci dessus dont ils reconnaissent l'importance. Ils réaffirment que, ainsi qu'il est indiqué au par.I, l'objectif final de leur politique monétaire est de restaurer, à des conditions appropriées, un étalon monétaire international basé sur l'or.

IV. Chacun des Gouvernements signataires dont la monnaie n'est pas sous le régime de l'étalon or s'engage à prendre les mesures jugées par lui les plus appropriés pour limiter la spéculation sur les changes, et chacun des autres Gouvernements soussignés s'engage à collaborer aux mêmes fins.

V. Chacun des Gouvernements soussignés est d'accord pour demander à sa Banque centrale de coopérer avec les Banques centrales des pays des autres Gouvernements signataires pour limiter la spéculation sur les changes, et pour, le moment venu, rétablir un étalon or international général.

VI. Le présent accord est ouvert à la signature des autres Gouvernements dont la monnaie est au régime de l'étalon or, ou dont la monnaie n'est pas à ce régime.

This document is dated 30/6/33 and pencilled, "Projet abandonné pour raison de refus américain." **Source:** M.F., B 32 323.

DOCUMENT A-3

3 Juillet 1933

Les Gouvernements soussignés:

Convaincus que le maintien de leurs monnaies est essentiel pour la réstauration économique et financière du monde, pour la reprise du crédit et pour la sauvegarde des progrès sociaux accomplis chez eux.

Confirment leur volonté formelle de maintenir le libre fonctionnement de l'étalon or dans leurs pays respectifs, aux parités or actuelles et dans le cadre des lois monétaires existantes.

Demandent à leurs banques centrales de demeurer en étroit contact pour donner à la présente déclaration le maximum d'efficacité.

Pour les Gouvernements de:

BELGIQUE	MM.Francqui
FRANCE	Rist
HOLLANDE	Trip
ITALIE	Guido Juny
POLOGNE	Koc
SUISSE	Bachmann

3 Juillet 1933

Original au Quai d'Orsay

This document is marked in pencil: "Déclaration des Etats fidèles au régime de l'étalon or."
Source: M.F., B 32 323.

DOCUMENT A-4

OFFICIAL STATEMENT RELATIVE TO PRESIDENT ROOSEVELT'S MESSAGE TO THE CONFERENCE

The President has made it clear that he saw no utility at the present time in temporary stabilisation between the currencies of countries whose needs and policies are not necessarily the same. Such stabilisation would be artificial and unreal and might hamper individual countries in realising policies essential to their domestic problem. He urged the conference to seek consideration of its fundamental task of facilitating policies by the different nations directly, not to temporary expedients, but to mitigating and, if possible, remedying the harassing evils of the present economic situation. In the hope that the United States may be of help to the conference, to whose success and friendly co-operation the President continues to attach the greatest importance, it may be useful that we should develop this thought somewhat more fully.

The revaluation of the dollar in terms of American commodities is an end from which the government and the people of the United States cannot be diverted. We wish to make this perfectly clear: we are interested in American commodity prices. What is to be the value of the dollar in terms of foreign currencies is not and cannot be our immediate concern. The exchange value of the dollar will ultimately depend upon the success of other nations in raising the prices of their own commodities in terms of their national moneys and cannot be determined in advance of our knowledge of such fact. There is nothing in our policy inimical to the interest of any other country and we are confident that no other country would seek to embarrass us in the attainment of economic ends required for our economic health.

When the currencies of those great nations of the Continent of Europe - France, Italy and Belgium - depreciated over a period of years, there was no criticism from the United States, nor did we criticise their ultimate devaluation. And when Great Britain and the Scandinavian countries went off the gold standard there was only sympathetic understanding in the United States. Great Britain has been off the gold standard for nearly a year and three-quarters and the United States has been off for less than three months. Nevertheless, we are glad to be able to associate ourselves with the statement of British policy made on July 4th in the House of Commons by the Financial Secretary to the Treasury, when, speaking in the name of the Chancellor of the Exchequer, he said:

"My right hon. friend has on a number of occasions expressed the view of His Majesty's Government that, although a return to the gold standard might be our ultimate objective when proper conditions were assured, we must reserve complete liberty to choose between both our own time and parity. He does not think he can usefully add anything to that statement now."

If there are countries where prices and costs are already in actual equilibrium we do not regard it to be the task of the conference, as it certainly is not the purpose of the American government, to persuade or compel them to pursue policies contrary to their own conception of their own interests.

It is not sufficient to escape from present evils. But it is our duty to consider together how to avoid their recurrence in the future. The first task is to restore prices to a level at which industry, and above all agriculture, can function profitably and efficiently. The second task is to preserve the stability of this adjustment once achieved. The part which gold and silver should play after adjustment has been secured would seem a further subject suitable for consideration by the conference.

We conceive therefore that the great problems which justify the assembling of the nations are as present today and as deserving of exploration as was the case a few weeks ago; and we find it difficult to conceive that the view which it has been our obvious duty to take on the minor issue of temporary stabilisation can in any way diminish the advisability of such discussion.

Source: Pasvolsky (1933), pp.160-162. "Transmitted July 5th by the American delegation to the conference."

DOCUMENT A-5

(Accord rigoureusement secret dont il)
(ne doit pas être fait état en dehors)
(des relations entre les banques cen-)
(trales intéressées.)

ACCORD DE COOPERATION

ARTICLE I. Les Banques centrales soussignées conviennent d'agir en commun pour la défense de l'étalon d'or et de leurs monnaies respectives à leurs parités-or actuelles, conformément à la déclaration de leurs Gouvernements en date du 3 Juillet 1933.

ARTICLE II. Aux fins ci-dessus les Banques soussignées se prêteront réciproquement assistance, notamment contre une spéculation éventuelle sur les changes, d'accord avec la Banque centrale intéressée, et fixeront, en conséquence, leur politique de crédit.

ARTICLE III. Chacune des banques surveillera le change des devises du groupe sur son marché et interviendra si il y a lieu, d'accord avec la Banque interessée et pour le compte de celle-ci.

Ces interventions se feront sans commission et à prix coûtant.

La Banque intéressée couvrira quotidiennement la Banque intervenante dans la devise de celle-ci ou en or.

ARTICLE IV. Chacune des Banques soussignées est diposée à placer de l'or sous dossier pour compte d'une autre Banque du groupe, notamment dans le cas du dernier paragraphe de l'article 3.

La Banque propriétaire de l'or sous dossier pourra le retirer en tout temps et <u>vers toutes destinations</u>. La Banque dépositaire demandera à son Gouvernement les assurances nécessaires qu'en toutes circonstances l'or restera libre pour l'exportation.

ARTICLE V. Les Services des changes des Banques soussignées coopérent entre eux aux fins des présentes. En outre, les Banques signataires se communiqueront tous les renseignements de nature à intéresser la stabilité des changes des pays intéressées, et désigneront les fonctionnaires chargés de cette liaison.

ARTICLE VI. L'entente ci-dessus est ouverte aux Instituts d'émission qui désireraient s'y joindre et qui, d'accord avec les signataires, pourraient apporter un concours utile à la défense de l'étalon-or.

ARTICLE VII. Sans préjudice à l'exécution des engagements déjà pris, le présent accord pourra être dénoncé sur préavis d'au moins un mois par lettre addressée à la Banque de France. L'accord subsistera entre les autres participants.

ARTICLE VIII. La collaboration de la Banque des Règlements Internationaux sera sollicitée pour tout ce qui relève de sa mission statutaire.

ARTICLE IX. Les Banques soussignées conviennent de se réunir à nouveau, sur demande de l'une d'entre elles, en vue d'examiner toutes les questions que poserait l'application du présent accord, chaque fois que la situation l'exigerait.

ARTICLE X. Le présent accord est rédigé en un seul exemplaire qui sera conservé dans les archives de la Banque de France; une expédition certifiée conforme sera remise à chacun des participants par les soins de la Banque de France.

Paris, le 8 Juillet 1933.

BANQUE NATIONALE DE BELGIQUE

BANQUE DE FRANCE

BANQUE D'ITALIE

BANQUE NEERLANDAISE

BANQUE DE POLOGNE

BANQUE NATIONALE SUISSE

(Les passages soulignés ont été ajoutés à la suite d'un échange de lettres entre les banques signataires.)

Source: M.F., B 32 323, various drafts, pencilled, "Accord de coopération technique entre les banques centrale des pays du bloc-or."

DOCUMENT A-6

ACCORD

entre la BANQUE DE FRANCE et la NEDERLANDSCHE BANK

pour l'application des articles III et IV
de l'Accord de Cooperation signé à Paris
le 8 Juillet 1933.

Article I. Conformément à la déclaration de leurs Gouvernements en date du 3 Juillet 1933, la Banque de France et la Nederlandsche Bank s'engagent à coopérer en vue du maintien de la stabilité monétaire, dans le cadre des lois existantes dans les deux pays.

Article II. Les deux Banques interviendront sur le marché des changes pour leur compte réciproque et exécuteront les ordres d'achat et de vente qu'elles se communiqueront.

Article III. Afin de faciliter son action sur les marchés des changes dans le cas où elle désirerait procéder à une intervention, la Nederlandsche Bank aura la faculté de se procurer auprès de la Banque de France, contre earmarking d'or, les devises dont elle aurait besoin pour régler ses opérations.

Article IV. Les soldes résultant de ces operations et effectivement disponibles seront réglés chaque jour. Sous réserve de la compensation des opérations journalières, la Nederlandsche Bank déclare son intention de procéder au règlement de ses soldes débiteurs auprès de la Banque de France par des earmarkings d'or dans ses caves et de demander qu'il soit procédé au règlement des soldes créditeurs lui appartenant par des earmarkings d'or dans les caves de la Banque de France.

Article V. Il est entendu que la Nederlandsche aura à tout moment la faculté de racheter l'or ainsi earmarked pour le compte de la Banque de France.

Article VI. Le prix auquel s'effectuent mutuellement les achats et les ventes d'or en vertu de cet accord sera le prix de vente de la Banque de France.

Article VII. A tout moment chacune des deux Banques pourra demander la compensation entre les dépôts d'or earmarked.

Article VIII. A tout moment chacune des deux Banques pourra demander l'expédition de l'or earmarked détenu par l'autre Banque. Les frais de transport de l'or earmarked seront à la charge de la Nederlandsche Bank.

Article IX. En vue d'assurer l'exécution du présent accord, les Services des Changes de la Banque de France et de la Nederlandsche Bank se tiendront en contact étroit et se communiqueront respectivement toutes les informations techniques de nature à intéresser les deux Banques.

Signé en deux exemplaires

à Paris et à Amsterdam, le 22 Juillet 1933

BANQUE DE FRANCE

DE NEDERLANDSCHE BANK N.V.
signé Trip

Source: M.F., B 32 323, other drafts exist with names of parties left blank. These are clearly pro-forma versions, one of these is pencilled, "Règlement technique mis en application pour la Banque Néerlandaise et la Banque d'Italie."

DOCUMENT A-7

PROTOCOLE

Les Gouvernments soussignées:

Convaincus comme ils l'ont affirmé à Londres, le 3 Juillet 1933, que la stabilité monétaire est l'une des conditions essentielles du retour à une situation économique normale;

Considérant qu'en assurant la stabilité de leurs monnaies ils contribuent à la restauration de l'économie mondiale;

Confirment leur volonté de maintenir les parités or actuelles de leurs monnaies respectives,

Reconnaissent que leur politique monétaire commune implique un développement des échanges internationaux, développement que doit favoriser entre eux la similitude des conditions monétaires existant dans leurs pays respectifs;

Conviennent:

I. de constituer une Commission Générale composée de leurs délégués respectifs;

II. En ce qui concerne les échanges internationaux:

1. de rechercher de quelle manière il est actuellement possible d'accroître les échanges entre leurs pays. Ils considérent comme désirable un accroissement de 10% du volume global des échanges effectués du 1er Juillet 1933 au 30 Juin 1934;

2. d'engager sans retard à cet effet des négociations bilatérales lesquelles devront aboutir dans le délai maximum d'un an;

3. de soumettre le projet de convention internationale relatif à la propagande commerciale, auquel ils donnent en principe leur approbation, à l'examen d'un sous-comité composé de chacun des Gouvernments soussignés avec mission d'arrêter définitivement le texte de la convention, de manière à en permettre la signature à bref délai.

III. En ce qui concerne le tourisme et les transports, de constituer deux sous-comités composés de représentants de chacun des Gouvernements sousignés, avec mission de faire un rapport à la Commission Générale sur les propositions dont celle-ci est dès à présent saisie ou qui lui seraient ultérieurement soumises.

IV. De réunir sans retard les sous-comités ci-dessus prévus et de convoquer à Bruxelles (sic) Commision Générale dans un délai de trois mois pour prendre connaissance de l'état des travaux et fixer la suite de son programme sans perdre de vue les intérêts des tiers et la nécessité d'une collaboration plus étendue sur le plan international.

Belgique	Jaspar
France	Lamoureux
Italie	Asquini
Luxembourg	Bech
Pays-Bas	Steenberge
Pologne	Dolezal
Suisse	Stucki

Source: M.F., B 32 323, pencilled, "Protocole signé par les représentants des Etats adhérents au Bloc or, le 20 Octobre 1934 à Bruxelles."

DOCUMENT A-8

PROJET DE NOTE AUX GOUVERNEMENTS AMERICAIN ET BRITANNIQUE

1. Le Gouvernement de la République, s'il a toujours écarté l'éventualité d'une dévaluation unilatérale, simple épisode de la lutte économique entre les nations, susceptible d'engendrer à son tour des dévaluations nouvelles, est au contraire très désireux d'une véritable paix économique et monétaire. Il y voit le seul moyen de mettre un terme au développement des tendances autarchiques, d'atténuer les restrictions et contraintes de toutes sortes qui paralysent les échanges et qui créent une atmosphère d'insécurité générale comportant pour la paix les plus graves dangers.

2. A cette fin le Gouvernement de la République désire en premier lieu remédier au déséquilibre économique engendré dans le monde par la baisse des prix et par les dévaluations corrélatives de certaines monnaies. Il est prêt, en ce qui le concerne, à participer à un accord de préstabilisation fixant de nouveaux rapports monétaires, avec précision et clarté, compte tenu du niveau mondial des prix. Les stipulations d'un pareil arrangement devraient être maintenues par la pratique d'une étroite collaboration entre les cocontractants et ne pourraient être modifiées que d'un commun accord ou en cas de circonstances exceptionnelles et imprévues, l'objectif final des contractants devant être le retour général à l'étalon or international quand les conditions nécessaires se trouveront realisées.

   Le texte qui figure en annexe de la présente note, s'il était contresigné par les banques d'émission intéressées, paraît de nature à conduire au résultat recherché.

3. Le Gouvernement de la République estime d'autre part que la conclusion de l'accord précité, en atténuant les déséquilibres qui isolent actuellement certaines économies nationales, devrait rendre possible une action immédiate et vigoureuse en vue de la réduction des obstacles aux échanges. Il est prêt à se concerter avec les Gouvernments américain et britannique sur les conditions dans lesquelles pareille action pourrait être entreprise en vue d'une reprise générale du commerce et des transactions internationales, qu'il tient pour la préface nécessaire à l'organisation politique de la paix.

PROJET D'ACCORD DE PRESTABILISATION

Les Hautes Parties contractantes décident de faire tous leurs efforts et d'établir entre elles la plus étroite collaboration en vue de maintenir les changes de leurs devises respectives entre les limites fixées dans le tableau ci-joint. Ces limites ne devront être modifiées que d'un commun accord ou, sous réserve d'en aviser les cocontractants, en cas de circonstances exceptionnelles et imprévues, l'objectif final des cocontractants étant le retour general à l'étalon-or international quand les conditions nécessaires se trouveront réalisées.

Source: M.F. B 32 325, pencilled, "Remis à M. Cochran et Monick le 8/9/36."
The currency grid mentioned in the text was not found in the archive.

DOCUMENT A-9

Le Conseil des Ministres a approuvé les termes d'une déclaration dont la teneurs a été arrêtée après d'amicales conversations entre les Gouvernement des Etats-Unis d'Amérique, le Gouvernement de la Grande-Bretagne et le Gouvernement français. Cette déclaration va être publiée ce soir simultanément par chacun des trois Gouvernement.

Le texte français est le suivant:

Prenant acte de cette déclaration, le Conseil des Ministres a approuvé les termes d'un projet de loi monétaire qui a pour objet essentiel d'ajuster la valeur du franc à la situation économique présente.

Le texte dispose notamment que la valeur or nouvelle du franc devra être comprise entre 49 et 43 milligrammes d'or au titre de 0,900 de fin. Il prévoit que jusqu'à nouvelle ordre un fonds de stabilisation des changes doté de 10 milliards de francs assurera la régularisation des rapports entre le franc et les devises étrangères en maintenant la parité du franc par rapport a l'or dans les limites ci-dessus visées.

En attendant l'adoption par les Chambres du projet de loi, la Banque de France prend les dispositions nécessaires pour enrayer les manoeuvres spéculatives. Le marché du franc sera étroitement contrôlé. Les Bourses de valeurs et de Commerce seront fermées pendant quelques jours.

(1) Le Gouvernement français, après s'être concerté avec le Gouvernement des Etats-Unis d'Amérique et le Gouvernement de la Grande-Bretagne, se joint à eux pour affirmer une volonté commune de sauvegarder la paix, de favoriser l'établissement des conditions qui pourront le mieux contribuer à restaurer l'ordre dans les relations économiques internationales et de poursuivre une politique tendant à développer la prospérité dans le monde et à améliorer le niveau de vie des peuples.

(2) Le Gouvernement des Etats-Unis et le Gouvernement de la Grande-Bretagne doivent naturellement dans la politique monétaire internationale tenir pleinement compte des exigences de la prospérité intérieure de la République Américaine et de l'Empire Britannique, de même que le Gouvernement français tiendra naturellement compte de considérations analogues en ce qui concerne l'économie de la Métropole et des possessions d'Outre-mer. Ils saisissent avec plaisir l'occasion qui leur est offerte de réaffirmer qu'ils entendent poursuivre la politique par eux pratiquées au cours des dernières années et dont un des objectifs constants est de maintenir le plus grand équilibre possible sur le marché international des changes et de ne rien négliger pour éviter qu'aucun trouble ne soit apporté dans cet équilibre du fait d'une action monétaire américaine ou britannique. Le Gouvernement français partage avec le Gouvernement des Etats-Unis d'Amérique et le Gouvernement de la Grande-Bretagne la conviction que la continuation de cette politique coordonnée servira les buts généraux que tous les Gouvernements devraient poursuivre.

(3) Le Gouvernement français, considérant que la stabilité désirable des principales monnaies ne peut être assurée sur des bases solides sans que soit préalablement rétabli un équilibre durable entre les diverses économies, a décidé dans ce but de proposer à son Parlement l'ajustement de sa devise. Le Gouvernement des Etats-Unis d'Amérique et le Gouvernement de la Grande-Bretagne, dans l'espoir que seront ainsi établies des fondations plus solides pour la stabilité des relations économiques internationales, ont acueilli favorablement cette décision. Le Gouvernement des Etats-Unis, le Gouvernement de la Grande-Bretagne et le Gouvernement français déclarent qu'il est de leur intention d'user des moyens appropriés dont ils disposent pour éviter dans toute la mesure du possible que des troubles puissent affecter les bases nouvelles des changes résultant de l'ajustement envisagé. Il est entendu que les consultations nécessaires seront assurées à cette fin avec les deux autres Gouvernements et entre les Instituts qualifiés.

(4) Le Gouvernment français est au surplus convaincu, comme le Gouvernement des Etats-Unis d'Amérique et le Gouvernement de la Grande-Bretagne, que le succès de la politique définie ci-dessus est lié au développement du commerce international. En particulier, il attache la plus grande importance à ce qu'une action soit entreprise sans délai pour atténuer progressivement, en vue de leur abolition, les régimes actuels de contingents et de contrôles des changes.

(5) Le Gouvernement français, comme le Gouvernement des Etats-Unis d'Amérique et le Gouvernement de la Grande-Bretagne, souhaite et sollicite la coopération des autres Nations pour la réalisation de la politique formulée dans la présente déclaration. Il compte qu'aucun pays n'essaiera d'obtenir un avantage de change déraisonnable et par là de contrecarrer l'effort qu'entendent poursuivre pour restaurer des relations économiques plus stables, le Gouvernement des Etats-Unis d'Amérique, le Gouvernement de la Grande-Bretagne et le Gouvernement français.

Source: M.F., B 32 325, apparently dated 25 September 1936.

DOCUMENT A-10

For Cochran, from the Secretary of the Treasury:

There follows below the text of Chancellor's communication.

1. Chancellor of the Exchequer welcomes Mr. Morgenthau's suggestion for cooperation between exchange controls by way of a mutual arrangement for the conversion of currency into gold and vice versa at prices to be agreed from day to day. He accepts proposed suggestion in principle and will gladly reciprocate on lines set out below.

2. An arrangement on similar lines is already in operation between Bank of England and Bank of France. Price is agreed between two banks on telephone in close relation to exchange rates of moment. Experience shows in order to maintain this close relationship price may have to be varied several times in the course of one day. This presents no difficulty with both markets open and with telephone communication frequent and cheap. Same conditions cannot obtain between Bank of England and Federal Reserve Bank of New York.

3. No difficulty arises as regards conversion of dollars into gold or vice versa. This can be effected on terms proposed by Mr. Morgenthau namely that United States Treasury will sell and buy gold at $35 per once (plus or minus ¼%) whenever British equalization account has occasion to convert dollars into gold or vice versa as a result of intervention in market.

4. But for conversion of sterling into gold it seems necessary to arrive at an agreed basis to suit conditions of the two markets which open and close at different times. Chancellor suggests therefore that any sterling acquired by the United States Treasury through control operations of Federal Reserve Bank should be converted into gold in London at price fixed in London market whether on that day or on previous day or at mean between the two as Mr. Morgenthau prefers. Similarly if United States Treasury were oversold in sterling as a result of their control operations Bank of England would be willing to buy gold from them on following day, for delivery in London at London price for gold determined as above. At option of Bank of England such gold could be set aside in New York instead of being shipped.

5. These minor modifications are technically necessary and Mr. Morgenthau will no doubt agree that they respect spirit and intention of his proposals. The arrangement will naturally be subject to such further technical adjustments as may be found to be desirable in practice. Chancellor assumes that (? arrangement) takes form of a special working understanding rather than of a formal agreement.

6. Chancellor notes that in proposal as made duration of understanding is indeterminate. He assumes that arrangement is intended to remain in force for an indefinite period subject to a right reserved to each side to suspend it or review it (without prejudice of

course to past transactions) on termination of draft agreement in the event of unforeseen circumstances arising.

7. Chancellor trusts that Mr. Morgenthau will be in agrement with foregoing and that under these conditions arrangement may result in effective cooperation between exchange controls.

8. Chancellor would be grateful for an opportunity of considering terms of any announcement found necessary in the United States and of coordinating any similar announcement if one becomes necessary.

In (sic.) have given you the text as we now have it. There is probably a garble in numbered paragraph 12 in regard to the phrase "on termination" which does not make clear sense.

CARR ACTING

Source: M.F. B 32 325, dated 14/10/36. This is the text of the 24hr. gold guarantee arrangements which regulated the rate at which central banks party to the agreement would deal with one another and the rates at which balances acquired though intervention would be exchangeable into gold.

DOCUMENT A-11

Dès le lendemain de la déclaration franco-anglo-américaine du 25 Septembre dernier, le Gouvernement belge a annoncé qu'il y donnait son adhésion. Le Gouvernement hollandais et le Gouvernement suisse viennent maintenant de faire connaître leur décision de s'y rallier également.

Le Gouvernement français accueille avec faveur les déclarations par lesquelles les Gouvernements de Belgique, de Suisse et de Hollande adhérent ainsi aux principes exposés dans la déclaration tripartite du 25 Septembre.

A la suite de ces adhésions, des dispositions ont été prises pour étendre à ces trois Pays les arrangements assurant les relations de change entre les places de Paris, Londres et New-York qui ont fait l'objet d'un communiqué en date du 13 octobre, et pour établir la collaboration des fonds d'égalisation ou de stabilisation des changes.

Ces dispositions font l'objet des deux communiqués suivants de la Trésorerie américaine et de la Trésorerie britannique.

1) Communiqué de la Trésorerie américaine:

"Comme suite aux avis donnés par lui les 31 janvier et 1er février 1934, prévoyant les achats d'or par la Trésorerie, et le 31 janvier 1934, concernant la vente de l'or pour l'exportation, le Secrétaire du Trésor déclare que dorénavant - et tant que, que après préavis de 24 heures, cette déclaration d'intention ne sera pas annulée ou modifiée - les Etats-Unis, en dehors des ventes d'or effectuées au bénéfice des fonds d'égalisation ou de stabilisation de pays étrangers, vendront aussi de l'or aux fins d'exportation immédiate (ou de consignation d'or earmarked) aux trésoreries (ou aux agents financiers quelconques intervenant pour leur compte ou dont les interventions en cette matière sont garanties par elles) des pays dont les trésoreries (ou les agents financiers quelconques intervenant ou garantis de la sorte) sont de la même manière disposées à vendre de l'or aux Etats-Unis, pourvu que de telles offres d'or soient faites à des taux et dans des conditions tels que le Secrétaire du Trésor puisse les estimer les plus avantageuses du point de vue de l'intérêt public. Le Secrétaire du Trésor fait connaître en outres d'ores et déjà la liste des pays étrangers qui remplissent les conditions ci-dessus indiquées et cette liste sera complétée chaque jour. Toutes les ventes d'or de l'espèce seront faites par l'intermédiaire de la Banque de Réserve Fédéral de New-York, agissant comme Agent financier des Etats-Unis, aux conditions suivantes que le Secrétaire du Trésor estime les plus avantageuses du point de vue de l'intérêt public.

L'or sera vendu au prix de 35 dollars par once de fin, plus ¼ pour les frais, et les ventes et consignations seront soumises aux règles édictées en application du Gold Reserve Act de 1934."

A la suite de ce communiqué, le Secrétaire du Trésor américain a fait connaître que dès maintenant il ajoutait sur la liste susvisée la Belgique, la Hollande et la Suisse.

2) Communiqué de la Trésorerie britannique:

"Le Gouvernement de S.M. a enregistré avec plaisir les déclarations que les Gouvernements de Hollande et de Suisse ont publiées hier en vue d'exprimer leur adhésion aux principes de la déclaration tripartite du 25 septembre, auxquels le 26 du même mois le Gouvernement belge avait déjà expressément adhéré.

Le Gouvernement de Sa Majesté a été informé que la Trésorerie des Etats Unis d'Amérique avait étendu à la Belgique, à la Hollande et à la Suisse les arrangements établis en vue d'assurer au sujet de la politique des changes la coopération technique qui avait été visée dans la déclaration du 13 octobre dernier. Le Gouvernement de S.M. accueille cette nouvelle décision avec faveur. Elle s'harmonise avec les arrangements déjà pris entre les Etats Unis d'Amérique et d'une part le Royaume Uni, d'autre part la France. L'extension de ces arrangements s'harmonise également avec les lignes générales de la coopération mutuelle existant entre les autorités monétaires britanniques et celles de la Belgique, de la Hollande et de la Suisse."

En ce qui le concerne: le Gouvernement français a l'intention de prendre les mesures nécessaires pour que le coopération technique instituée entre le Fonds de stabilisation des changes français et les fonds d'égalisation américain et britannique soit étendue aux Instituts d'émission ou Fonds de stabilisation de Belgique, de Hollande et de Suisse. Les autorités monétaires des ces Pays bénéficieraient désormais des mêmes facilités en ce qui concerne la délivrance de l'or contre devises, et elles assureraient au fonds de stabilisation français un traitement analogue.

Source: M.F. B 32 325, dated 23 November 1936. This document confirms the extension of the 24hr. gold guarantee arrangements to the Belgian, Dutch and Swiss monetary authorities following their acceptance of the Tripartite declarations of 25th September 1936.

DOCUMENT A-12

The United States Treasury is prepared, on the basis of reciprocity, to authorize transfers of earmarks of gold between the treasuries, exchange equalization or stabilization funds, or fiscal agencies, referred to in the announcement of the Secretary of the Treasury of October 13 and November 24, 1936, as well as the central banks of such countries.

This authority would be revocable at any time with respect to any transfer not fully consummated at that time. Both with respect to earmark and to transfers of earmarks, the authority would extend, in accordance with present regulations of the Federal Reserve Bank of New York, only to such gold as is the property of the institution for whose benefit the earmark is created.

The United States Treasury would appreciate being advised as to the attitude of the governments and institutions concerned on the foregoing proposal.

Source: M.F. B 32 325, dated 26/1/37. This proposal amounts to a clearing of gold balances held under earmark within any central bank party to the 24hr. gold guarantee thus saving the expense of shipping and insurance, as well as not alerting markets to gold shipments (i.e., reserve movements).

DOCUMENT A-13

23 mai 1933.

NOTE SUR L'OPEN MARKET POLICY

I. Avant d'exposer le mécanisme de l'open market policy, il convient de rappeler les principes du fonctionnement de l'étalon or;

Les entrées d'or, en augmentant le volume de la circulation monétaire d'un pays, tendent à faire monter les prix. La hausse des prix a pour effet de stimuler les importations et de ralentir les exportations de marchandises, c'est à dire de faire naître un déficit de la balance des comptes. La naissance de ce déficit met un terme aux entrées d'or.

A l'inverse, les sorties d'or, en réduisant le volume de la circulation monétaire, tendent a faire baisser les prix. La baisse des prix stimule les exportations et entrave les importations, c'est à dire améliore la situation de la balance des comptes et met ainsi un terme aux sorties d'or.

Grâce aux réactions qu'ils exercent sur les prix, les mouvements d'or ont donc l'avantage d'assurer le rétablissement automatique de l'équilibre de la balance des comptes.

II. L'open market policy consiste, pour une banque d'émission, à acheter et à vendre des titres, effets bancaires, bons du Tresor, et (sic)... sur le marché monétaire. Elle achète des titres quand elle se propose d'accroître le volume de la circulation monétaire et du crédit; elle en vend quand elle désire réduire le volume de la circulation monétaire et restreindre le crédit.

Un double but peut être assigné à l'open market policy:

soit, empêcher les mouvements d'or de provoquer une contraction ou une expansion de la circulation. Ce but est atteint lorsque la banque d'émission, dès qu'elle perd de l'or, intervient sur le marché et achète des titres pour éviter une diminution de la circulation monétaire:

soit, accentuer les effets des mouvements d'or. Ce but est atteint lorsqu'une banque d'émission, dès qu'elle perd de l'or, vend des titres pour provoquer une plus forte contraction monétaire et précipiter ainsi la baisse des prix qui rétablira l'équilibre de la balance des comptes.

III. Dans le premier cas, l'emploi de l'open market policy est contraire au mécanisme de l'étalon or. Il empêche le rétablissement automatique de l'équilibre de la balance des comptes.

Les difficultés monétaires rencontrées au cours de ces dernières années par l'Angleterre et les Etats Unis ont été dues, dans une large mesure, au fait que l'open market policy a été utilisé pour neutraliser les effets des mouvements d'or.

En Angleterre, par exemple, l'Institut d'émission a acheté, entre le 15 juillet et le 23 septembre 1931, c'est à dire pendant les deux mois qui ont précédé l'abandon de l'étalon or, £30 millions de titres sur le marché. Ces achats ont eu pour objet de compenser l'effet produit par la diminution de l'encaisse qui, pendant la même, période s'était également élevée aux environs de £30 millions.

En suivant cette politique, la Banque d'Angleterre n'a pas permis aux sorties d'or d'exercer leur influence sur le volume de la circulation et le niveau des prix. Elle a favorisé la spéculation à la baisse de la livre sterling car elle a évité le resserrement monétaire qui, seul, pouvait entraver les opérations de la spéculation. Cette politique a été en grande partie responsable de la chute de la livre sterling.

Aux Etats Unis, l'open market policy a eu également pour objet de neutraliser les effets des mouvements d'or. Mais les autorités fédérales ont voulu aussi se servir de ce moyen pour déterminer une hausse des prix.

C'est ainsi que de juin 1931 à juin 1932, les Banques de réserve fédérale ont acheté $1.200 millions de titres sur le marché dans l'espoir que cette politique provoquerait une hausse des prix. En agissant ainsi, elles n'ont réussi qu'à affaiblir le gage métallique de la circulation et ébranler la confiance dans la stabilité du dollar, sans arrêter d'ailleurs la baisse des prix qui, pendant cette période, a atteint plus de 10%.

La politique de neutralisation des mouvements d'or a d'ailleurs été formellement condamnée par la Délégation de l'or constituée par la S.D.N. comme incompatible avec le fonctionnement normal de l'étalon or. La délégation de l'or n'a admis l'emploi de l'open market policy que si celle ci a pour objet d'accentuer les effets des mouvements d'or.

IV. La délégation de l'or a, toutefois, reconnu qu'elle ne s'imposait pas en France où, par suite de la structure spéciale du marché français, elle serait sans influence appréciable sur le volume du crédit et le niveau des prix.

L'open market policy ne s'impose, en effet, que dans les pays où; comme en Angleterre et aux Etats Unis, le chèque est le principal instrument de paiement. En Angleterre, par exemple, tandis que la circulation de billets s'élève à £370 millions, le montant des dépôts bancaires privés (qui circulent sous forme de chèques) s'élève à près de £2 milliards. Il en résulte que le volume de la circulation monétaire est placé davantage sous le contrôle des banques privées que de la Banque d'Angleterre.

Dès lors, pour qu'une sortie d'or exerce une action sur le niveau des prix, il est indispensable, non seulement qu'elle provoque une diminution de la circulation de la Banque d'Angleterre, mais aussi et, surtout, qu'elle détermine une contraction du volume du crédit privé. La Banque d'Angleterre ne peut atteindre ce dernier résultat que si, par des ventes de titres, elle crée un resserrement suffisamment marqué pour obliger les banques privées à restreindre leurs prêts.

V. En France, la situation est différente. Le principal instrument de paiement est le billet de banque et non le chèque. La circulation des billets s'élève, en effet à 85 milliards alors que le montant des dépôts dans les quatres grandes sociétés de crédit ne s'élève qu'à 35 milliards de francs.

Il en résulte qu'en France le volume de la circulation monétaire est placé, en majeure partie, sous le contrôle de la Banque de France et toute sortie d'or entraîne une contraction monétaire suffisante pour agir sur le niveau des prix.

Il convient d'ajouter que dans le domaine du crédit et de l'escompte, la Banque de France joue un rôle bien plus actif que la Banque d'Angleterre et les Banques de Réserve fédérale.

La Banque de France a 260 succursales réparties sur tout le territoire national. Elle entretient des relations d'affaires, non seulement avec les autres banques, mais avec tout le commerce et l'industrie. Elle accepte, en effet, d'escompter directement aux entreprises.

La Banque d'Angleterre n'a que 7 succursales. Les Banques de réserve fédérale n'en ont pas. Ces deux Institus d'émission n'entretiennent des relations d'affaires qu'avec les banques privées. Elles n'escomptent pas le papier remis directement par les entreprises commerciales ou industrielles.

En n'escomptant que le papier remis par les banques privées, la Banque d'Angleterre et les Banques de réserve fédérale se trouvent placées, en matière de crédit et d'escompte, sous la dépendance des grandes banques de dépôts. La Banque de France, au contraire, grâce au rôle plus actif qu'elle joue en matière d'escompte, est à même de contrôler plus efficacement le taux privé de l'argent et par suite, le volume du crédit privé.

Source: M.F., B 32 323.

DOCUMENT A-14

le 22 septembre 1933.

MOYEN D'ACTION SUR LE MARCHE MONETAIRE DONNE A LA BANQUE DE FRANCE PAR LA CONVENTION DU 23 JUIN 1928

En exécution de conventions passées le 23 juin 1928 et le 7 décembre 1931, la Caisse d'Amortissement a pris en charge l'amortissement des Bons du Trésor jusqu'alors détenus par la Banque de France, d'une part en représentation d'avances de l'Etat à des Gouvernements étrangers (bons russes), d'autre part en compensation de la perte subie par la Banque, du fait de la dépréciation de certaines devises étrangères.

En échange de ces bons du Trésor, il a été remis à la Banque de France des bons de caisse sans intérêt à 3 mois d'échéance.

Aux termes des conventions intervenues, la Banque de France "aura la faculté de négocier sur le marché les bons de caisse, si elle le juge utile, pour agir sur le volume du crédit et garder le contrôle de sa circulation; elle pourra également racheter avant leurs échéances les bons ainsi negociés."

La vente des bons de caisse aurait ainsi pour effet de provoquer un certain resserrement sur le marché des capitaux. A l'inverse, en rachetant ces bons, la Banque pourrait augmenter l'aisance du marché monétaire.

En fait la Banque n'a jamais usé de la faculté qui lui à ainsi été donnée. Au surplus, il convient de noter que l'importance de ce moyen d'action diminue chaque année, car, au fur et à mesure que la Caisse Autonome amortit les bons dont elle a reçu la charge, la Banque de France remet à la Caisse un montant égal de bons de caisse. C'est ainsi que le montant de ces bons qui s'élevait au 31 décembre 1931 à 6.898.658.000 F., n'était plus au 31 décembre 1932 que de 6.802.407.000 F., dont 4.652.435.000 F., représentant les bons de caisse émis en vertu des conventions du 23 juin 1928 et 2.149.972.000 F. les bons émis pour l'application des conventions du 7 décembre 1931.

Source: M.F., B 32 323.